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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

In the second quarter of 2004 there was considerable slowing in the rate of increase in the value of "good" agricultural land for the Seventh Federal Reserve District, as key agricultural prices dropped (especially corn and soybeans). As of July 1, 2004, the quarterly increase in farmland values fell to 1 percent, on average, for the District as a whole, based on a survey of 303 agricultural bankers. For the 12 months ending June 30, the increase was 9 percent, higher than the year-over-year increase seen for the second quarter last year but lower than as of the end of the first quarter of 2004. There were also fewer respondents that anticipated farmland values would rise during the second quarter, compared with the first quarter.

Moreover, credit conditions showed some signs of slipping, though generally remaining better than a year ago. Loan demand in the past three months was a bit higher than a year earlier, and fewer renewals and extensions of loans were generated in the quarter. The rate of loan repayment was higher than the previous year, though down a little from the prior quarter. The availability of funds was less than a quarter ago and the previous year. Also, interest rates on agricultural loans started to rise across the District. Nearly the same proportion of banks required increased collateral as last quarter. Loan-to-deposit ratios were the highest in a year and a half, averaging 73.7 percent at the end of the second quarter. The proportion of farm loans that bankers viewed as having "major" or "severe" repayment problems was down from last year at this time.

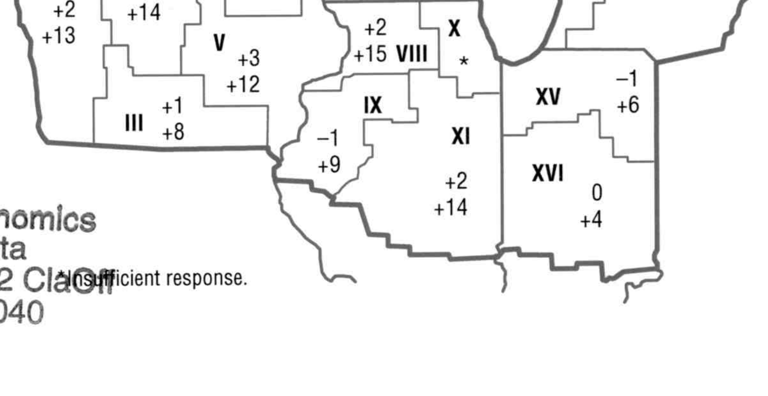
Farmland values

After a very strong quarterly increase, the average value of "good" agricultural land in the District increased less rapidly in the second quarter of 2004. The 1 percent rise in farmland values for the District (quarter-to-quarter) resulted from slower growth in Illinois, Iowa, and Wisconsin, and no growth in Indiana and Michigan (see table and map below). The average year-over-year increase in District farmland values was 9 percent, again lower than in the first quarter. Illinois and Iowa saw the strongest gains from a year ago (13 percent and 12 percent, respectively). Indiana and Michigan slowed the most with increases of 4 percent and 3 percent over a year ago, respectively. Wisconsin, meanwhile, was in between with a 6 percent gain. A major factor in the downshifting of farmland value increases was the decrease in key agricultural prices over the quarter, especially for corn and soybeans. But continued demand from nonfarm investors, still historically low interest rates, and the lack of farmland for sale helped to counter the downward arc in agricultural prices.

Percent change in dollar value of "good" farmland

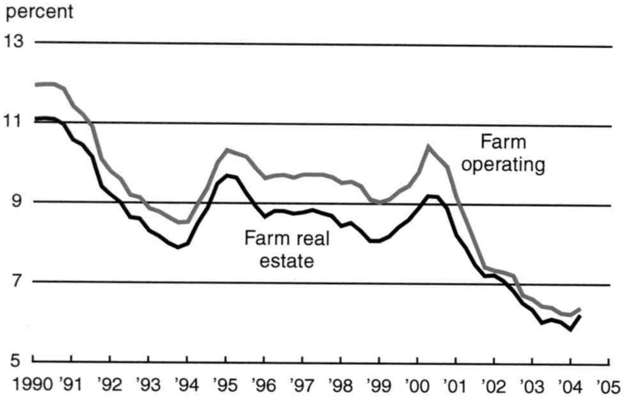
Top: April 1, 2004 to July 1, 2004
Bottom: July 1, 2003 to July 1, 2004

	April 1, 2004 to July 1, 2004	July 1, 2003 to July 1, 2004
Illinois	+2	+13
Indiana	0	+4
Iowa	+2	+12
Michigan	0	+3
Wisconsin	+3	+6
Seventh District	+1	+9



*Insufficient response.

Quarterly District farm loan interest rates



Even with lower growth in farmland values, 44 percent of respondents expected increases during the July to September quarter, while 54 percent expected farmland values to remain stable. Only in Illinois did a majority anticipate rising farmland values. At least 40 percent of the responding bankers expected farmland values to be up in Indiana, Iowa, and Wisconsin. Few respondents predicted lower farmland values during the third quarter.

Credit conditions

Credit conditions took a step back in the second quarter, but were still ahead of a year ago. Loan demand kept expanding, though barely, due to strength in Indiana and Iowa. Just 23 percent of the respondents saw demand rise for non-real-estate agricultural loans compared with a year ago, whereas 31 percent reported increased demand in the first quarter of 2004. With lower demand seen by 22 percent of the respondents, the index of non-real estate agricultural loan demand fell to 101, better than last year at this time.

Renewals and extensions eased back from year-ago levels, with 21 percent, on average, of the bankers reporting a decrease, and only 7 percent reporting an increase. Continuing a recent trend, collateral requirements relative to a year earlier were stricter once again, but just 8 percent of respondents required more collateral in the past three months. Comparatively more banks in Indiana, Michigan, and Wisconsin tightened collateral requirements than the District as a whole.

Though not as good as last quarter, non-real-estate farm loan repayment rates from April to June were above the levels of a year ago. As 24 percent of the bankers noted higher rates of loan repayment and only 6 percent noted lower rates, the index of loan repayments was 118, the second best in the last decade. Wisconsin saw the biggest improvement, assisted by the earlier rebound in milk prices, followed by Indiana and Iowa. Moreover, almost 90 percent of the banks' farm loan portfolios had no significant repayment problems, a 5 percent increase over the second quarter last year. Just 3 percent of the loan volume for responding banks was reported as in the "major" or "severe" problem categories—half the level of a year earlier.

Fund availability improved again in the second quarter of 2004, but at the lowest rate in three years. With 26 percent of the bankers saying they had more funds available during the quarter than they had a year ago and 9 percent reporting a lower amount of funds available for lending, the index of fund availability fell to 117, a three-year low. Indiana actually had slightly more banks note lower than higher levels of funds available to lend.

Additionally, the average loan-to-deposit ratio for the District was 73.7 percent, the highest since the end of 2002. Only Illinois, at 65.7 percent, was below the District average, while Indiana, Michigan, and Wisconsin exceeded it. Moreover, there was a noticeable increase in the percentage of banks that reported being above their desired loan-to-deposit ratio (15 percent versus 11 percent a year ago). In particular, a higher percentage than the District average was computed for Indiana, Iowa, and Michigan. One concern was that low deposits, possibly due to the short soybean crop last year, created difficulties for some agricultural banks. Still, a majority of banks reported their loan-to-deposit ratio was at or below the desired level.

After a long period of declining interest rates, farm loan interest rates moved upward (see chart). As of July 1, the District average for interest rates on new operating loans rose to 6.39 percent, still below the level of a year ago. Interest rates for farm mortgages increased to 6.23 percent. The interest rate spread narrowed again to 16 basis points, the smallest difference in three years. Interest rates on operating loans ranged from 6.05 percent in Illinois to 6.66 percent in Wisconsin, on average. For farm real estate loans, Illinois also had the lowest rate, 6.14 percent, and Michigan had the highest rate, 6.44 percent. Banks in Illinois averaged the same interest rate on operating loans as last quarter.

In recent years commercial banks have faced increased competition from other financial sources, especially the Farm Credit System (FCS) and input suppliers. Commercial banks loaned 40 percent of U.S. farm debt in 2003, while the FCS share had risen to 30 percent, according to data from the U.S. Department of Agriculture. The FCS has been particularly successful in making agricultural real estate loans (37 percent), though commercial banks still had 34 percent of the total loaned. However, commercial banks held the largest share of non-real-estate farm loans at 48 percent, followed by the FCS at 22 percent and individuals and others (including input suppliers) at 25 percent.

Farm-related lending from nonbank sources in District states has been higher than usual again this year, with only life insurance companies generating less than normal activity. About 30 percent of the reporting bankers said that FCS lending for farm operating loans had advanced faster than normal, while 51 percent reported above-normal levels of FCS

Credit conditions at Seventh District agricultural banks

	Loan demand	Fund availability	Loan repayment rates	Average loan-to-deposit ratio[1]	Interest rates on farm loans: Operating loans[1]	Feeder cattle[1]	Real estate[1]
	(index)[2]	*(index)*[2]	*(index)*[2]	*(percent)*	*(percent)*	*(percent)*	*(percent)*
2001							
Jan-Mar	118	101	67	75.0	9.16	9.17	8.23
Apr-June	106	109	73	75.1	8.60	8.58	7.91
July-Sept	91	127	86	74.9	8.01	8.07	7.47
Oct-Dec	101	129	75	72.8	7.41	7.51	7.21
2002							
Jan-Mar	108	118	66	72.7	7.33	7.48	7.22
Apr-June	105	120	71	75.1	7.28	7.35	7.08
July-Sept	99	124	76	75.7	7.21	7.26	6.84
Oct-Dec	101	130	88	73.2	6.70	6.78	6.51
2003							
Jan-Mar	109	130	79	72.4	6.61	6.75	6.36
Apr-June	99	138	84	72.7	6.43	6.52	6.04
July-Sept	95	129	86	72.9	6.41	6.47	6.12
Oct-Dec	97	127	104	71.8	6.26	6.35	6.05
2004							
Jan-Mar	116	131	128	73.2	6.22	6.28	5.87
Apr-June	101	117	118	73.7	6.39	6.46	6.23

[1]At end of period.

[2]Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

farm mortgage loans. Merchants, dealers, and other input suppliers kept lending at a pace above the usual, as indicated by 42 percent of respondents, while 8 percent saw lending below normal. Just 9 percent of respondents reported higher loan volumes for life insurance companies, but 21 percent noted lower loan volumes. Only in Illinois did life insurance companies seem to be holding onto their loan volume.

Over 80 percent of respondents stated that the amount of farm lending by their bank was higher or the same as in the first and second quarters of 2003. About the same percentage of the reporting bankers saw farm operating loans above normal levels at their institution as last year (with 25 percent above normal and 15 percent below). For mortgage lending by banks there was a reversal from a year ago, since 27 percent of the respondents' banks experienced higher than normal farm mortgage lending and 19 percent faced lower than normal lending. At reporting banks farm operating loans were up from 2003 in Illinois, Indiana, and Iowa; farm mortgage loans were up in Indiana, Iowa, and Wisconsin. Michigan was the only state where banks saw declines for both types of farm loans.

Looking forward

For July through September of 2004, 22 percent of the responding bankers indicated they expect higher non-real-estate loan volume relative to the previous year, while 17 percent expect lower volume (about 60 percent of the respondents expect loan volumes to remain the same). Notably, bankers expected loan volume to increase for farm machinery loans and operating loans (to a lesser extent), but to decrease for feeder cattle, dairy, and Farm Service Agency guaranteed loans. Strength in anticipated grain storage construction loans for Illinois, Indiana, and Iowa continued from the first quarter.

Similar to non-real-estate loan activity, 21 percent of those reporting said they expected higher real estate loan volume, while just 10 percent expected lower volume. Almost 70 percent of the respondents expected loan volumes would remain the same in the third quarter of this year compared with a year ago. Again it was Illinois, Indiana, and Iowa that paced the anticipated growth in real estate loan volume. So, as with non-real-estate lending, real estate loan activity in July, August, and September should resemble that of a year ago.

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SELECTED AGRICULTURAL ECONOMIC INDICATORS

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(index, 1990-92=100)*	July	122	–4.7	16	23
Crops *(index, 1990-92=100)*	July	116	–4.9	6	6
Corn *($ per bu.)*	July	2.42	–13.3	12	14
Hay *($ per ton)*	July	90.40	–5.0	2	–1
Soybeans *($ per bu.)*	July	8.21	–9.3	41	53
Wheat *($ per bu.)*	July	3.36	–6.1	14	5
Livestock and products *(index, 1990-92=100)*	July	128	–3.8	27	45
Barrow and gilts *($ per cwt.)*	July	57.30	0.4	33	43
Steers and heifers *($ per cwt.)*	July	91.1	–2.6	15	37
Milk *($ per cwt.)*	July	16.2	–11.0	34	46
Eggs *(¢ per doz.)*	July	58.9	–12.4	–14	4
Consumer prices *(index, 1982-84=100)*	July	189	–0.2	3	5
Food	July	187	0.3	4	6
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	2,970	N.A.	–1	–17
Soybean stocks *(mil. bu.)*	June 1	410	N.A.	–32	–40
Wheat stocks *(mil. bu.)*	June 1	546	N.A.	11	–30
Beef production *(bil. lb.)*	July	2.10	–5.5	–14	–13
Pork production *(bil. lb.)*	July	1.58	–5.7	0	1
Milk production* *(bil. lb.)*	July	12.5	0.8	1	2
Receipts from farm marketings *(mil. dol.)*	May	18,525	1.7	24	32
Crops**	May	8,011	–3.3	11	20
Livestock	May	10,514	6.0	36	43
Agricultural exports *(mil. dol.)*	June	4,427	–9.8	2	9
Corn *(mil. bu.)*	June	133	–15.8	–8	–22
Soybeans *(mil. bu.)*	June	20	1.0	–37	–53
Wheat *(mil. bu.)*	May	93	–10.9	53	50
Farm machinery *(units)*					
Tractors, over 40 HP	July	9,241	–10.8	35	42
40 to 100 HP	July	7,588	–8.4	30	36
100 HP or more	July	1,653	–20.2	69	80
Combines	July	671	9.8	45	102

N.A. Not applicable
*20 selected states.
**Includes net CCC loans.

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