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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Slightly higher rates of increase in the value of "good" agricultural land for the Seventh Federal Reserve District were supported by continued pressure from development and interest from nonfarm investors. Based on a survey of 282 agricultural bankers as of July 1, 2003, the quarterly increase in farmland values rose to 2 percent, on average, for the entire District. For the twelve months ending June 31, the increase was 7 percent, exceeding the year-over-year increase posted for the quarter last year. More respondents expected farmland values to go up and less expected farmland values to decline in the next three months.

Credit conditions exhibited mixed signals. On the positive side, the availability of funds was greater than a year ago and the previous quarter. Interest rates on agricultural loans continued to fall across the District. The rate of loan repayment was higher than the previous quarter and the previous year. Moreover, the proportion of farm loans that respondents viewed as having "major" or "severe" repayment problems was virtually unchanged from last year at this time. About the same proportion of banks required increased collateral as last year. However, a continuation of the weak loan demand seen in the past three months is expected. More renewals and extensions of loans were generated in the quarter than a year earlier according to the bankers, but at a slower pace. Loan-to-deposit ratios inched up, averaging 72.7 percent at the end of the second quarter.

Farmland values

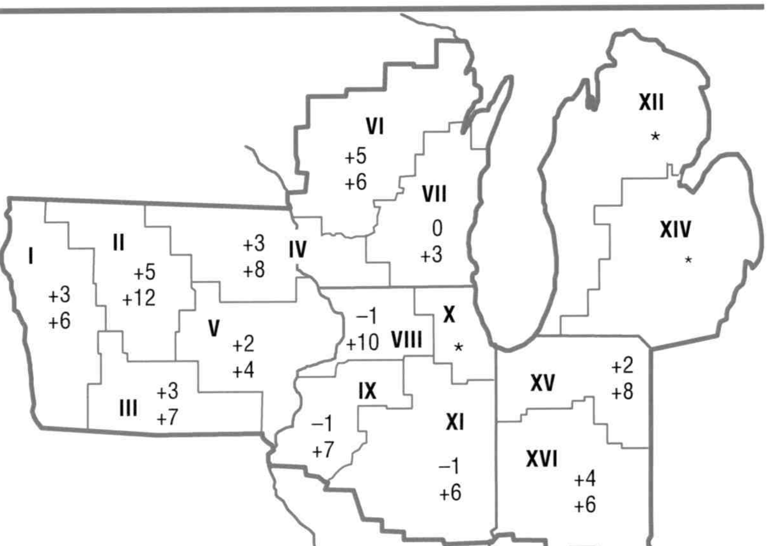
The average value of "good" agricultural land in the District rose again in the second quarter of 2003. Survey results were fairly consistent among District states (see map and table below). But, the rate of change in farmland values for Illinois differed from the other states with a 1 percent drop (quarter-to-quarter), whereas the rest of the District states had a 2 percent increase. The average year-over-year increase in District farmland values was 7 percent, slightly more than the first quarter. Michigan led with an 8 percent gain. Wisconsin was just below the District average, managing to gain 6 percent even with dairy operations stymied by low milk prices.

Though 72 percent of responding bankers expect farmland values to remain stable during the July to September quarter, most of the remainder still expect farmland values to rise. In Illinois, Indiana, and Iowa at least 25 percent of the bankers predicted a rise in farmland values, whereas the percentage of respondents that expected lower farmland values was a bit larger in Michigan and Wisconsin. With no District-wide changes expected in farmland supply and demand factors, farmland values are likely to continue rising this quarter.

Percent change in dollar value of "good" farmland

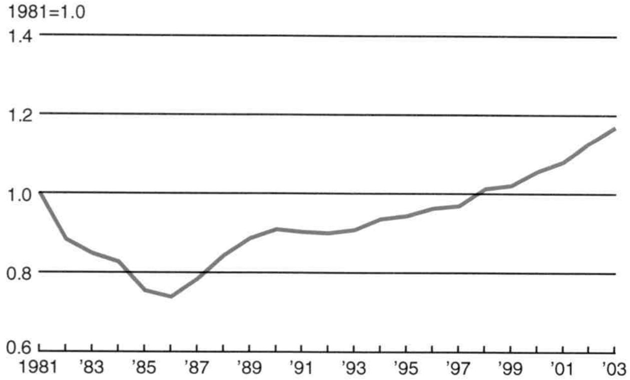
Top: April 1, 2003 to July 1, 2003
Bottom: July 1, 2002 to July 1, 2003

	April 1, 2003 to July 1, 2003	July 1, 2002 to July 1, 2003
Illinois	−1	+7
Indiana	+3	+7
Iowa	+3	+7
Michigan	+3	+8
Wisconsin	+3	+6
Seventh District	+2	+7



*Insufficient response.

1. District price to earnings ratio



Note: Derived from indexes based on Federal Reserve Bank of Chicago Land Value and Credit Condition Surveys.

After the stock market downturn in recent years, bankers have expressed concerns about whether farmland values may fall precipitously, especially when interest rates rise. One technique to assess the sustainability of asset values is the price to earnings (P/E) ratio. According to a basic asset valuation model, the present price of an asset should reflect current profitability and expectations for future earnings. One approach to estimating the earnings component for farmland uses cash rental rates. Then the P/E ratio for the farmland market can be constructed as the ratio of an average farmland value per acre and the cash rental rate per acre.

The District P/E ratio for farmland has grown substantially since 1986 (see chart 1). The average annual growth in the P/E ratio has been 2.6% over the last ten years. Unlike the stock markets in the late 1990s, this moderate growth does not seem to indicate farmland values are out of touch with earnings potential. Even though the P/E ratio may reverse in the near future as farmland supply and demand shift, especially if interest fades among nonfarm investors, a drastic drop in farmland values seems a remote possibility given the lack of uncontained growth typical of a "bubble."

Credit conditions

There continued to be mixed results among credit conditions in the second quarter. There was an upswing in renewals and extensions, with 24 percent, on average, of the bankers noting an increase, and only 6 percent noting a decrease. Lenders in Wisconsin reported levels of renewals and extensions 12 percent above the District average, as dairy farmers struggled to contend with very low milk prices. Respondents noted an increase in collateral requirements relative to a year earlier, with 19 percent requiring a higher level of collateral in the past three months, slightly less than the recent past. Banks in Illinois again led the Seventh District in tightening collateral requirements.

At the same time, only 23 percent of the bankers reported higher demand for non-real estate agricultural loans as compared with 31 percent in the first quarter of 2003. A number similar to that reported a quarter earlier saw lower demand (24 percent) for non-real estate agricultural loans. Thus, the index of loan demand dropped to 99, matching the low of last year.

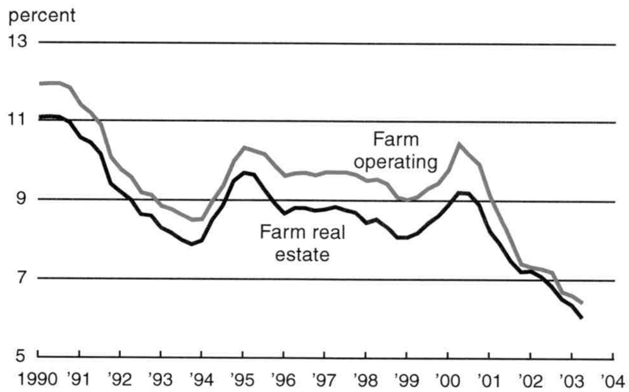
A brighter result is that the respondents indicated non-real estate farm loan repayment rates improved from last quarter, and were better than this quarter last year. About 22 percent of the bankers reported lower rates of loan repayment, while only 6 percent reported higher rates. These numbers pushed up the index of loan repayments to 84. Yet, no improvement was evident in the bankers' responses to a question regarding the volume of farm loans with repayment problems. For the District on average, respondents noted that 6 percent of their loan volume was in the "major" or "severe" problem categories, the same as last year.

In the second quarter of 2003, agricultural banks once again had more funds available to lend. Around 42 percent of the bankers reported they had more funds available from April to June than they had a year earlier, an increase compared to last quarter and last year at this time. There were fewer banks (4 percent) that reported a lower amount of funds available for lending, so the index of fund availability rose to 138, a new 10-year high.

Continuing a three-year trend, banks reported that farm loan interest rates declined (see chart 2). As of July 1, the District average for interest rates on new operating loans had fallen to 6.43 percent, exactly 4 percentage points below the peak in 2000. Interest rates for farm mortgages were down over 3 percentage points from their last peak in 2000. The spread between these interest rates narrowed from 122 to 39 basis points over three years.

So far this year farm-related lending from nonbank sources in District states has been noticeably above normal.

2. Quarterly District farm loan interest rates



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)*
2000							
Jan-Mar	121	95	77	72.9	9.78	9.72	8.89
Apr-June	109	76	72	75.5	10.43	10.14	9.21
July-Sept	106	82	77	76.9	10.17	10.14	9.18
Oct-Dec.	105	92	81	74.9	9.92	9.90	8.90
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

[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.

About 40 percent of the respondents reported that Farm Credit System (FCS) lending for farm operating loans was running above the normal pace, while 58% indicated above-normal FCS lending for farm mortgage loans. Merchants, dealers, and other input suppliers were still lending more than normal, as 46 percent of respondents reported, about the same as last year. In contrast, life insurance companies continue to wane as agricultural lenders. Only 11 percent of respondents saw higher loan volumes for life insurance companies, but 21 percent reported lower loan volumes. Holding their own, 24 percent of the reporting bankers saw farm operating loans above normal levels at their institution (with just 14 below). However, 25 percent of the respondents saw lower than normal farm mortgage lending, and only 18 percent saw above normal levels.

Looking forward

For the third quarter of 2003, 18 percent of the respondents indicated they expect higher non-real estate loan volume relative to a year earlier, while an identical 18 percent expect lower volume. Similarly, 15 percent reported foreseeing higher real estate loan volume, while 17 percent reported lower volume expectations. Over 65 percent of the bankers expected loan volumes would remain the same in the third quarter of this year compared with a year ago. Thus, neither a pickup nor a slide in overall agricultural loan demand is likely this quarter.

Yet, expectations for loan volume in the third quarter of 2003 remained somewhat higher for operating loans and loans guaranteed by the Farm Service Agency. For these types of loans, 28 percent and 25 percent of bankers, respectively, expected increased lending, while about 10 percent expected fewer loans.

Additionally, the differences among states are worthy of mention. The expectations in Indiana, Iowa, and Michigan were for a slight increase in non-real estate loan volume. Only in Iowa was there any expectation for higher real estate loan volume. On the other hand, one-third of Wisconsin bankers predicted declines in volume for both types of loans.

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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)*	August	108	2.9	8	−2
Crops *(index, 1990-92=100)*	August	112	2.8	−1	3
Corn *($ per bu.)*	August	2.13	−1.8	−11	12
Hay *($ per ton)*	August	85.30	−4.2	−8	−12
Soybeans *($ per bu.)*	August	5.56	−4.6	1	15
Wheat *($ per bu.)*	August	3.44	16.6	−5	26
Livestock and products *(index, 1990-92=100)*	August	105	4.0	21	−5
Barrow and gilts *($ per cwt.)*	August	41.60	−3.7	28	−19
Steers and heifers *($ per cwt.)*	August	81.70	3.7	21	11
Milk *($ per cwt.)*	August	13.0	8.3	15	−21
Eggs *(¢ per doz.)*	August	78.5	12.6	28	39
Consumer prices *(index, 1982–84=100)*	July	184	0.1	2	4
Food	July	180	0.1	2	4
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	2,985	N.A.	−17	−24
Soybean stocks *(mil. bu.)*	June 1	602	N.A.	−12	−15
Wheat stocks *(mil. bu.)*	June 1	492	N.A.	−37	−44
Beef production *(bil. lb.)*	July	2.44	2.0	0	12
Pork production *(bil. lb.)*	July	1.58	3.3	1	10
Milk production* *(bil. lb.)*	July	12.4	−0.1	1	3
Receipts from farm marketings *(mil. dol.)*	May	14,937	−1.3	6	2
Crops**	May	7,306	5.4	9	18
Livestock	May	7,631	−7.0	4	−10
Government payments	May	N.A.	N.A.	N.A.	N.A.
Agricultural exports *(mil. dol.)*	June	4,351	−0.6	7	6
Corn *(mil. bu.)*	June	144	10.0	−15	−7
Soybeans *(mil. bu.)*	May	39	−41.9	−15	−3
Wheat *(mil. bu.)*	May	60	4.9	−2	−15
Farm machinery *(units)*					
Tractors, over 40 HP	July	6,841	−19.6	5	8
40 to 100 HP	July	5,855	−19.9	5	15
100 HP or more	July	986	−17.9	8	−19
Combines	July	467	33.8	41	−17

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

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