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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Nonfarm investors again paced an increase in the demand to purchase farmland in the third quarter, leading to a rise in the value of "good" agricultural land for the Seventh Federal Reserve District. Based on a survey of almost 300 agricultural bankers as of October 1, 2003, the quarterly increase in farmland values was 1 percent, on average, for the entire District. For the 12 months ending September 30, the increase was 7 percent. The year-over-year increase matched that of last year. Even more bankers than last year expected farmland values to go up and fewer expected farmland values to decline in the next three months.

Agricultural credit conditions were worse than a year ago, according to District bankers. More renewals and extensions of loans were generated in the third quarter than a year earlier, according to the respondents. The rate of loan repayment was down from last year in the District. More banks required increased collateral. The availability of funds was less than the prior quarter, though up from a year ago. But, the demand for loans was the lowest in two years. Real estate interest rates edged up after three years of decreases, though interest rates on agricultural operating loans dropped again. Loan-to-deposit ratios climbed to

the highest average of the year, still about 5 percent below the average the bankers reported as their desired ratio. So, there were predominantly negative signs in agricultural credit conditions.

Farmland values

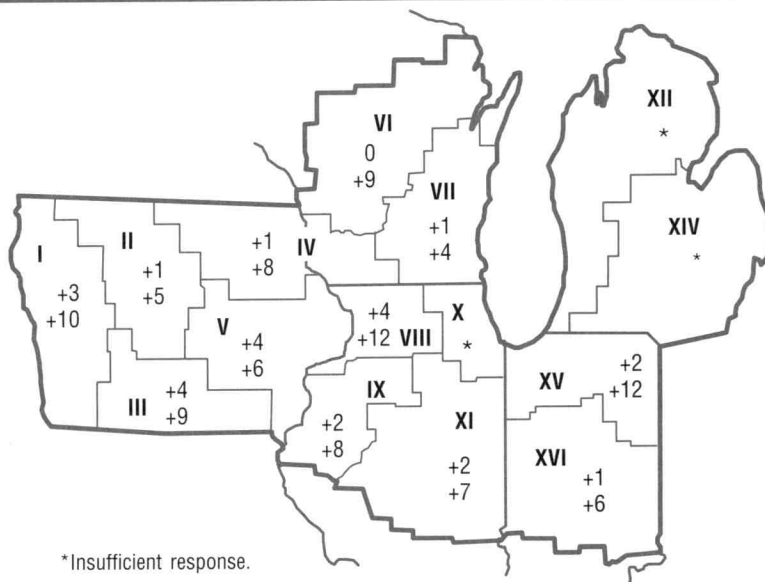
The value of "good" agricultural land increased in the third quarter of 2003, but not uniformly across District states (see table and map below). From July 1 to October 1, the rate of change in Michigan's farmland values dropped behind the other states' with a 2 percent decrease (quarter-to-quarter). Wisconsin once more had stagnant farmland values this quarter, as dairy prices picked up from lows not seen since the 1970s. Farmland value gains in Indiana, where too much precipitation hampered planting and harvesting, have also slowed, with a 1 percent increase, on average, in the third quarter. Illinois and Iowa showed growth of 2 percent for the quarter. With strong overall corn yields and lower soybean yields offset by higher prices, net farm income may increase this year in contrast with last year's decline, but not where drought cut yields and dairy operations struggled to survive. Moreover, the uneven recovery of the nonfarm economy may partly explain the differences in farmland value changes due to reduced pressure from development.

Percent change in dollar value of "good" farmland

Top: July 1, 2003 to October 1, 2003

Bottom: October 1, 2002 to October 1, 2003

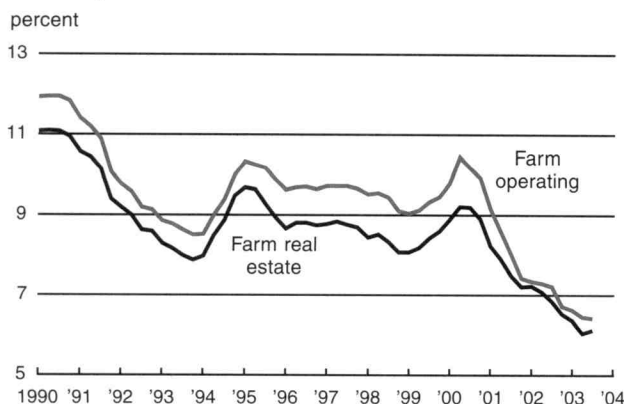
	July 1, 2003 to October 1, 2003	October 1, 2002 to October 1, 2003
Illinois	+2	+8
Indiana	+1	+8
Iowa	+2	+8
Michigan	-2	+3
Wisconsin	0	+7
Seventh District	+1	+7



*Insufficient response.

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Quarterly District farm loan interest rates



The increase in District farmland values was 7 percent compared to a year ago. Michigan, reversing its relative position, recorded a 3 percent gain, while Illinois, Indiana, and Iowa reported 8 percent gains. These gains were supported by demand from nonfarm investors, which seems to have increased once again. Spurred by demand from the nonfarm sector, 35 percent of Seventh District bankers anticipated farmland values to rise, with only 2 percent seeing a fall. In no state was there a higher proportion of respondents that expect farmland values to fall than rise during the next three months.

Credit conditions

In the third quarter District credit conditions declined overall. The respondents indicated that non-real-estate farm loan repayment rates were lower than a year ago, though rates were worse for a smaller share of banks than last quarter or the third quarter of 2002. About 21 percent of the bankers reported lower rates of loan repayment, while only 7 percent reported higher rates. These numbers increased the index of loan repayment rates to 86 (see table on page 3). Even though there were more renewals and extensions, with 20 percent, on average, of the bankers noting an increase, and 8 percent noting a decrease, this increase was lower than last quarter and this quarter last year. Lenders in Wisconsin reported the lowest levels of loan repayments. Indiana had the best levels of loan repayments, as well as being the only state with balanced increases and decreases in the levels of renewals and extensions. Banks once again tightened collateral requirements, with 14 percent requiring a higher level of collateral in the past three months, though this was a smaller percentage than in the third quarter of 2002.

In the third quarter of 2003, agricultural banks had more funds available to lend, but there was lower demand for agricultural loans. Over 30 percent of the bankers

reported they had more funds available during July, August, and September than they had a year earlier. All District states reported improved funds availability, with the smallest proportion (27 percent) of bankers in Indiana noting increased funds availability. The index of fund availability was 129, lowest of the year but higher than this time last year. Meanwhile, 17 percent of the bankers reported higher demand for non-real-estate loans and 22 percent reported a decline. Thus, the index of loan demand dropped to 95, the lowest in two years. In Indiana and Iowa, the index of loan demand rose, in contrast with the other states. There was very little increased demand for non-real-estate loans in Wisconsin reported for last quarter, and the proportion of banks reporting decreases was by far the biggest in the District.

Having reached the highest levels of the year in the third quarter, the average loan-to-deposit ratio of 72.9 percent (see table) was around 5 percent below the desired ratio given by respondents. Breaking down the results, 14 percent of bankers reported their bank's loan-to-deposit ratio was higher than desirable, and 62 percent thought the ratio was lower than desirable.

Banks reported that farm loan interest rates had declined for operating and feeder cattle loans, but not for real estate loans (see chart and table). As of October 1, the District average for interest rates on new operating loans had fallen to 6.41 percent, over 400 basis points lower than the cyclical peak of three years ago. And, at an average of 6.12 percent, interest rates for farm mortgages were down over 300 basis points from the last peak, though up slightly from last quarter. This may indicate a bottoming out in farm real estate loan rates. Once again the spread narrowed between these loan types.

Looking forward

In comparison with the fourth quarter a year ago, 22 percent of the bankers reported that they expect higher non-real estate loan volume this quarter, while only 17 percent expect lower volume. Respondents look for increases primarily in operating loans (30 percent) and Farm Service Agency (FSA) guaranteed loans (28 percent). Only 19 percent foresee higher real estate loan volume, whereas 15 percent foresee lower real estate loan volume. At least 60 percent of the respondents indicated that they expected loan volumes of all kinds would remain the same in the fourth quarter of this year compared with a year ago. Of particular note, in Iowa over 40 percent anticipate higher volumes for operating loans, reflecting stress from relatively poor crop yields. And for Indiana and Iowa only, at least 10 percent more respondents expect higher than lower real estate loan volume in the fourth quarter.

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		
	(index) ²	(index) ²	(index) ²	(percent)	Operating loans ¹	Feeder cattle ¹	Real estate ¹
2000					(percent)	(percent)	(percent)
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
July-Sept	95	129	86	72.9	6.41	6.47	6.12

¹At end of period.

²Bankers 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.

Bankers were asked to indicate if they expect to rely more heavily on the USDA's FSA farm loan guarantees during October through December than they did during the same period a year ago.¹ Although 28 percent of the respondents indicated that more loans would have FSA guarantees, just 7 percent indicated a reduction in their utilization of the guarantees. These numbers represent a greater reliance on FSA guaranteed loans than last year.

A large proportion (60 percent) of bankers again expected higher demand from nonfarm investors for the purchase of agricultural land in their areas over the next six months compared with a year ago. There was speculation that investors continued to seek safe havens for funds, given the performance of other investment opportunities in the past few years and the desire for diverse portfolios. Just in Indiana and Iowa, bankers anticipated greater interest by farmers in the purchase of agricultural land. Thirty percent of Wisconsin bankers expected a retreat in interest in land by farmers, especially as they foresee an increase in forced sales or liquidation of farm assets among financially stressed farmers. Except in Indiana, District bankers projected increased forced sales and liquidations over the next six months compared with last year, though the overall percentage is lower than last year. Additionally, 28 percent foresee lower volumes of farm loan repayments and only 13 percent foresee higher volumes.

Over 30 percent of respondents foresee the volume of farmland transfers continuing to increase, whereas

11 percent foresee a decrease. This trend is seen by some as cashing in chips after a good run of play. Even though farmland values continued to rise this quarter, several bankers expressed concerns about the agricultural economy if interest rates begin rising. Given the mixture of positive and negative signals for the District farm economy, many bankers seem to be holding their breath.

David B. Oppedahl, *Economist*

¹FSA guarantees apply to ownership and operating loans to farmers who do not meet the standards of conventional lenders. Guarantees may apply up to 90 percent of the loan principal, and lenders may resell the guaranteed portion in a secondary market.

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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)	October	113	2.7	19	20
Crops (index, 1990-92=100)	October	111	0.0	10	26
Corn (\$ per bu.)	October	2.02	-8.2	-14	10
Hay (\$ per ton)	October	84.40	0.2	-10	-14
Soybeans (\$ per bu.)	October	6.94	14.5	33	70
Wheat (\$ per bu.)	October	3.23	-4.7	-26	13
Livestock and products (index, 1990-92=100)	October	116	5.5	33	12
Barrow and gilts (\$ per cwt.)	October	38.10	-5.0	21	-6
Steers and heifers (\$ per cwt.)	October	97.40	8.9	42	39
Milk (\$ per cwt.)	October	14.8	2.8	22	-5
Eggs (¢ per doz.)	October	84.1	7.4	58	41
Consumer prices (index, 1982-84=100)	October	185	-0.1	2	4
Food	October	182	0.6	3	4
Production or stocks					
Corn stocks (mil. bu.)	September 1	1,086	N.A.	-32	-43
Soybean stocks (mil. bu.)	September 1	169	N.A.	-19	-32
Wheat stocks (mil. bu.)	September 1	2,036	N.A.	16	-6
Beef production (bil. lb.)	October	2.21	-4.4	-12	-7
Pork production (bil. lb.)	October	1.91	14.8	4	4
Milk production* (bil. lb.)	October	12.0	2.8	0	2
Receipts from farm marketings (mil. dol.)	July	17,193	12.2	5	2
Crops**	July	8,208	8.3	1	12
Livestock	July	8,985	16.1	8	-6
Agricultural exports (mil. dol.)	September	4,404	2.4	12	13
Corn (mil. bu.)	September	149	21.3	24	-9
Soybeans (mil. bu.)	September	37	11.9	18	15
Wheat (mil. bu.)	August	121	34.6	29	31
Farm machinery (units)					
Tractors, over 40 HP	October	8,482	25.6	15	13
40 to 100 HP	October	5,822	5.1	16	19
100 HP or more	October	2,660	119.1	12	3
Combines	October	546	-16.9	-30	-34

N.A. Not applicable

*20 selected states.

**Includes net CCC loans.

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