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The Agricultural Newsletter
from the Federal Reserve Bank of Chicago
Number 1931 February 2006

AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Capping the strongest two years of growth since the 1970s, the annual increase in farmland values was 10 percent in 2005, based on surveys completed by 258 agricultural bankers in the Seventh Federal Reserve District. The quarterly gain in the value of "good" agricultural land for the District was 2 percent in the fourth quarter of 2005. Just under 30 percent of the respondents expected farmland values to increase in the first quarter of 2006 and almost 70 percent expected them to remain stable.

District agricultural credit conditions slipped from the beginning of 2005, recovering a bit in the fourth quarter, while agricultural interest rates continued their climb, as of January 1, 2006. Indexes of loan demand, loan repayment rates, and funds availability were above the levels of the third quarter of 2005, although loan repayment rates were below the level of a year ago. Loan renewals and extensions in the fourth quarter were below the level of the previous quarter, but were higher than a year earlier. Required collateral was higher for October to December 2005 than for the same period in 2004. Loan-to-deposit ratios were down to 75.8 percent from the third quarter, which is about 4 percentage points below the ratio preferred by District bankers.

Farmland values

Following a 12 percent rise in 2004, the value of "good" agricultural land in the District posted a 10 percent increase in 2005. With consecutive years of double-digit gains, a similar spurt in District farmland values (23 percent from 2003 to 2005) last occurred in the 1970s. Indeed, when adjusted for inflation, farmland values have not increased at the pace of the last two years in nearly three decades (see chart on next page). Wisconsin continued to exhibit the largest annual increase at 13 percent (see table and map below). Illinois and Iowa farmland values rose 10 percent for the year. Indiana and Michigan were below the District average at 9 percent and 6 percent, respectively.

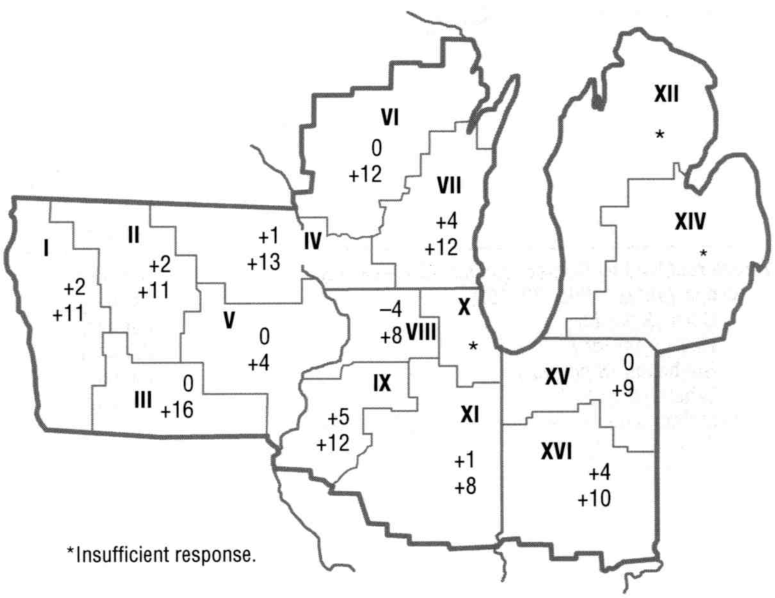
Responding bankers cited the same factors as in previous surveys for the increase in land values, although the factors may have varied by location. These factors included strong demand for farmland by investors, particularly for recreational purposes, tax-deferred exchanges, and, at least in some areas, a limited number of farms for sale.

Moreover, the second-highest U.S. net cash farm income on record, according to the U.S. Department of Agriculture (USDA) forecast, helped extend the upswing in farmland values. Crop receipts in 2005 dropped $12 billion, as the corn and soybean crops were the second largest after the record-setting harvest of 2004. In conjunction,

Percent change in dollar value of "good" farmland

Top: October 1, 2005 to January 1, 2006
Bottom: January 1, 2005 to January 1, 2006

	October 1, 2005 to January 1, 2006	January 1, 2005 to January 1, 2006
Illinois	+2	+10
Indiana	+3	+9
Iowa	+1	+10
Michigan	+4	+6
Wisconsin	+2	+13
Seventh District	+2	+10



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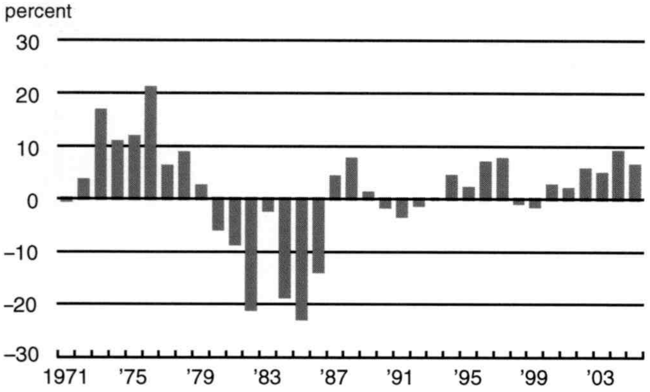
Annual percentage change in Seventh District farmland values adjusted by CPI-U



Note: Derived from Federal Reserve Bank of Chicago farmland value surveys and BLS Consumer Price Index series (annual average).

key crop prices, such as corn and soybeans, were lower in 2005 than in 2004. As a consequence, direct government payments jumped almost $10 billion from 2004. Also, the value of livestock production rose $2.4 billion from 2004. With higher costs for purchased inputs, interest on loans, and labor, 2005 net cash farm income slid to $82.8 billion from the record of $85.5 billion in 2004. The combination of a record year followed by a near-record year for net cash farm income helped spur rising farmland values.

While District corn and soybean crops were also the second largest, 2005 results varied within the District. Based on USDA data, District corn production fell 6.7 percent from 2004's record to 5.48 billion bushels, and soybean production dropped 1.3 percent to 1.39 billion bushels. Yields were reduced by drought, primarily in Illinois (an 18 percent decrease in corn and a 10 percent decrease in soybean output), but also in eastern Iowa and northern Indiana. Indiana corn output fell 4 percent, and soybean output fell 7 percent. Iowa corn production fell 4 percent, but soybean production rose 7 percent. In contrast, Wisconsin had a 21 percent increase in corn production and a 30 percent increase in soybeans. Likewise, Michigan experienced higher output for both corn and soybeans (12 percent and 3 percent, respectively). However, due to price declines, only Wisconsin had an increase in the combined value of production for corn and soybeans (10 percent). The 2005 value of corn and soybean output for the District fell 12 percent from 2004.

Less than 30 percent of respondents expected farmland values to keep rising in the first quarter of 2006. A few bankers expected land values to fall, but 68 percent expected values to be stable from January through March. A common perception was that land values have reached a plateau, since interest, fuel, and fertilizer costs have risen, while commodity prices have fallen. In some areas, respondents commented that the pressure from tax-deferred exchanges had eased. Additionally, uncertainty about future USDA payments has contributed to the perception that farmland values will stabilize.

Credit conditions

The steady increase in interest rates for agricultural loans acted as a drag on both farmland values and credit conditions. As of January 1, 2006, the District average for interest rates on new operating loans was 8.02 percent, 34 basis points higher than three months ago. At an average of 7.25 percent, interest rates for farm real-estate loans rose by 23 basis points. Interest rates on agricultural loans were lowest in Illinois, which helped compensate for the effects of the drought. With operating loans averaging 7.67 percent, Illinois was the only state below 8 percent.

Furthermore, collateral requirements rose at District banks, with 14 percent raising the amount of collateral required during October to December 2005, although 85 percent did not change collateral requirements. Collateral requirements increased the most in Illinois and Indiana. Likewise, one-third of the bankers reported tightening credit standards for agricultural loans in the fourth quarter versus the previous year, while only 2 percent reported easing. Given tighter credit standards, 2 percent of customers with operating credit were not likely to qualify for new credit this year from the responding banks, double the level of a year ago. This doubling was influenced most by bankers in Wisconsin who reported that 5 percent of their customers were unlikely to receive new operating credit.

The index of non-real-estate farm loan repayment rates moved up a bit to 90 from the third quarter, indicating that loan repayments slipped at a slightly lower rate. Ten percent of the bankers reported higher rates of loan repayment, 20 percent reported lower rates, and 70 percent expected stable rates of repayments. Drought-related problems in Illinois led one-third of the bankers there to report lower rates of loan repayment versus a year ago. Slightly more than 4 percent of the volume of the banks' agricultural loan portfolios was classified as having major or severe repayment problems, up from six months ago and a year ago. Still, 87 percent of loan volume had no significant repayment problems.

Not surprisingly, Illinois also led an upturn in the rate of renewals and extensions of loans compared to the fourth quarter of 2004. With 19 percent of District bankers indicating higher renewals and extensions than a year ago and 13 percent indicating lower levels, renewals and extensions reinforced the mixed nature of credit

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Credit conditions at Seventh District agricultural banks

	Loan demand	Funds availability	Loan repayment rates	Average loan-to-deposit ratio	Interest rates on farm loans: Operating loans[1]	Feeder cattle[1]	Real estate[1]
	(index)[2]	(index)[2]	(index)[2]	(percent)	(percent)	(percent)	(percent)
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
July–Sept	109	111	112	74.5	6.57	6.61	6.28
Oct–Dec	109	121	127	74.1	6.81	6.80	6.39
2005							
Jan–Mar	117	112	116	74.4	7.07	7.08	6.63
Apr–June	119	101	103	76.3	7.33	7.30	6.74
July–Sept	115	97	87	76.9	7.68	7.65	7.02
Oct–Dec	120	110	90	75.8	8.02	7.95	7.25

[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.

conditions. While Indiana also had higher levels, Iowa, Michigan, and Wisconsin bankers reported lower levels of loan renewals and extensions in 2005.

Demand for non-real-estate loans rose as well during October, November, and December from a year ago, with the index of loan demand increasing to 120. More than twice as many bankers reported an increase in the demand for non-real-estate loans as reported a decrease (36 percent versus 16 percent). Illinois, Indiana, and Iowa experienced elevated non-real-estate loan demand, whereas Michigan and Wisconsin had lower demand for non-real-estate loans last quarter.

Some banks expressed concerns about their ability to garner deposits, but funds availability increased across the District relative to 2004's fourth quarter. With 22 percent of the respondents reporting higher funds availability and 13 percent lower, the index of funds availability was 110. This reversed the decline of last quarter and added a fifth year to the trend for increased funds availability.

Looking forward

Credit conditions may deteriorate in 2006 based on USDA's forecast of net cash farm income falling 22 percent from 2005. The 2006 forecast has the value of agricultural production dropping 2 percent and direct government payments shrinking 20 percent, with manufactured input costs growing 7 percent and interest payments rising 11 percent. Given the fact that drought has lowered the subsoil moisture available in much of the District, timely rains this growing season will be essential to avoid a more serious decline in credit conditions in 2006.

For January, February, and March of 2006, almost 40 percent of the respondents expected higher levels of non-real-estate loan volume (versus 10 percent lower), particularly for operating loans and those guaranteed by the Farm Service Agency. Only 18 percent of the bankers reported projections of higher real-estate loan volume in the first quarter of 2006, compared to 13 percent projecting lower volume. Moreover, the surveyed bankers expected capital expenditures by farmers to fall in the year ahead, restricting loan demand for 2006.

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AgLetter (ISSN 1080-8639) is published quarterly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by David B. Oppedahl, business economist, and members of the Bank's Research Department. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

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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)*	January	112	−2.6	1	0
Crops *(index, 1990–92=100)*	January	107	−2.7	5	−6
Corn *($ per bu.)*	January	1.96	2.1	−8	−18
Hay *($ per ton)*	January	91.20	−0.9	4	14
Soybeans *($ per bu.)*	January	5.51	−4.5	−1	−25
Wheat *($ per bu.)*	January	3.48	−1.7	1	−5
Livestock and products *(index, 1990–92=100)*	January	117	−2.5	−3	6
Barrow and gilts *($ per cwt.)*	January	41.90	−5.8	−22	13
Steers and heifers *($ per cwt.)*	January	101.00	1.1	7	18
Milk *($ per cwt.)*	January	14.5	−2.0	−9	10
Eggs *(¢ per doz.)*	January	61.0	−15.2	9	−34
Consumer prices *(index, 1982–84=100)*	January	198	0.8	4	7
Food	January	194	0.6	3	6
Production or stocks					
Corn stocks *(mil. bu.)*	December 1	9,813	N.A.	4	23
Soybean stocks *(mil. bu.)*	December 1	2,502	N.A.	9	48
Wheat stocks *(mil. bu.)*	December 1	1,430	N.A.	0	−6
Beef production *(bil. lb.)*	December	2.06	−0.7	1	4
Pork production *(bil. lb.)*	December	1.87	1.2	0	0
Milk production *(bil. lb.)**	January	14.0	3.0	5	7
Agricultural exports *(mil. dol.)*	December	5,567	−8.9	−2	13
Corn *(mil. bu.)*	December	165	3.7	−9	−14
Soybeans *(mil. bu.)*	December	83	−40.7	−46	−41
Wheat *(mil. bu.)*	November	79	−25.0	−8	1
Farm machinery *(units)*					
Tractors, over 40 HP	January	6,533	−23.3	−5	12
40 to 100 HP	January	4,613	−26.2	2	22
100 HP or more	January	1,920	−15.2	−19	−5
Combines	January	336	−58.6	−5	33

N.A. Not applicable
*23 selected states.
Note: *AgLetter* will no longer publish data on receipts from farm marketings. Please contact the USDA for this data.
Source: Data from USDA, U.S. Bureau of Labor Statistics, and the Association of Equipment Manufacturers.

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