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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS IN THE THIRD QUARTER, 2006

Summary

Third quarter farmland values were unchanged from those of the second quarter of 2006, and the year-over-year increase slowed to 7 percent for "good" agricultural land in the Seventh Federal Reserve District. The survey results, based on the responses of 241 agricultural bankers as of October 1, 2006, provided evidence of cooling after two years of double-digit gains in farmland values. About a quarter of the respondents expected land values to increase in the fourth quarter of 2006 (71 percent forecasted stable values).

Agricultural credit conditions worsened from the third quarter of 2005, District bankers reported. District loan repayment rates were down from the third quarter a year earlier, while loan renewals and extensions were up. Collateral requirements increased a bit in the District, and the availability of funds constrained more District banks. Demand for non-real-estate loans strengthened compared with demand a year ago. Average interest rates on agricultural loans stopped moving upward for the first time since the start of 2004. The average loan-to-deposit ratio established a new top at 79.1 percent, though still 2.4 percent below the preferred ratio.

Farmland values

The value of "good" agricultural land in the District was unchanged in the third quarter from the second quarter of 2006. The quarterly results for District states (see map and table below) ranged from a loss of 2 percent in Illinois to 1 percent gains in Indiana, Iowa, and Wisconsin. The year-over-year increase in land values slowed to 7 percent (see chart 1) after 10 quarters of 9 percent or greater growth. Though all states except Indiana had lower rates of increase from a year ago, once again Wisconsin had the biggest increase in land values. These results were a mixture of gains and losses in value as location seemed to play a larger role this quarter. A key factor in areas with land value declines was lessened pressure from housing demand, aided by interest rates at high enough levels to slow demand from nonfarm investors. In areas with land value increases, there was continued demand for recreational purposes and interest in farm expansion to meet demand for biofuel inputs. In some areas, farmers have been priced out of land purchases; in others, farmers keep buying land.

The proportion of responding bankers expecting farmland values to increase in the next three months remained under a quarter, with 5 percent expecting declines. Iowa respondents exhibited the highest expectations (30 percent) that farmland values will rise during the fourth

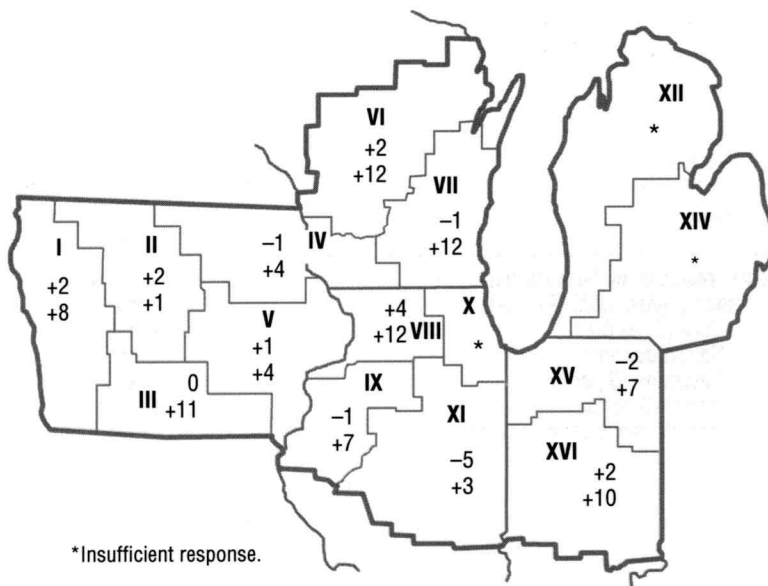
Percent change in dollar value of "good" farmland

Top: July 1, 2006 to October 1, 2006

Bottom: October 1, 2005 to October 1, 2006

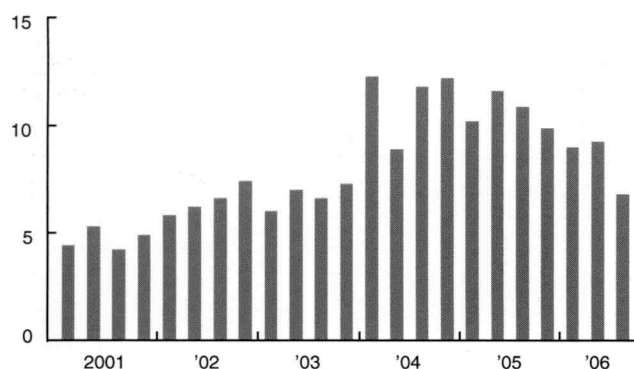
	July 1, 2006 to October 1, 2006	October 1, 2005 to October 1, 2006
Illinois	-2	+6
Indiana	+1	+9
Iowa	+1	+5
Michigan	0	+5
Wisconsin	+1	+11
Seventh District	0	+7

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1. Year-over-year changes by quarter in District farmland values

percent



quarter of 2006. In all states, at least two-thirds forecasted no changes in land values from October to December.

In contrast with a year ago, more bankers predicted higher rather than lower interest in land purchases among farmers (the difference was just over 10 percent). There was higher demand for farmland among nonfarm investors, though not as strong as a year ago, with 20 percent more of the respondents forecasting interest by nonfarm investors going up versus down over the next three to six months. In Illinois, Indiana, and Iowa, demand from both groups was anticipated to increase. Michigan respondents expected lower demand from both groups, but Wisconsin bankers only expected lower demand by farmers. Thirty percent of the respondents forecasted increases in the volume of farmland transfers from the previous fall and winter, while 16 percent anticipated lower volumes of transfers. Michigan and Wisconsin faced the opposite results from the rest of the District.

Net cash farm earnings in the District explain in part the results regarding farmer demand for land. For crop, cattle, and hog farmers, roughly even percentages of the respondents expected increases versus decreases in net cash farm earnings over the next three to six months compared with a year earlier. Uncharacteristically, prices for corn and soybeans rose substantially during harvesting, boosting crop revenue projections and raising feed costs. District production was anticipated to decrease 1.0 percent for corn to 5.42 billion bushels and increase 5.6 percent for soybeans to 1.45 billion bushels from 2005 (based on estimates of the U.S. Department of Agriculture). However, for dairy farmers, 46 percent more respondents expected lower rather than higher net cash farm earnings due to low milk prices and higher costs.

In states with dimmer prospects for net farm income, more respondents indicated that farmers would have less interest in acquiring farmland. For instance, Wisconsin respondents painted a dire picture of net cash income for the state, as 86 percent expect declines from dairy operations and 35 percent predict declines from

cattle and hog operations. Not surprisingly, almost 10 percent more Wisconsin bankers anticipated lower overall demand for land by farmers. On the other hand, Illinois crops, as well as Indiana soybeans, bounced back from yields reduced by drought in 2005. Survey results indicated that farmers in Illinois and Indiana should have improved net cash income. Also, planned increases in ethanol production seemed to affect the calculations of farmers as they anticipated higher corn prices. In general, higher expectations for net farm income corresponded with higher demand by farmers for land.

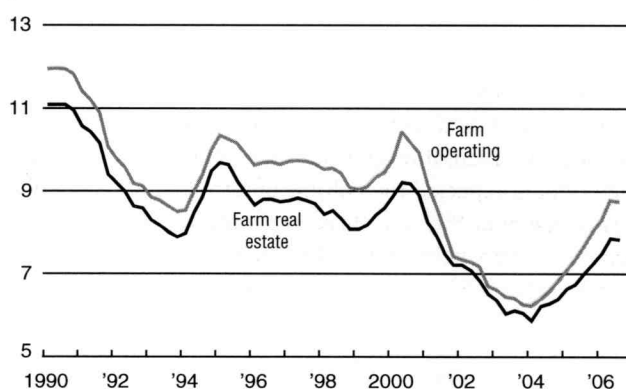
Credit conditions

Credit conditions continued to deteriorate in the third quarter of 2006. Areas with lower expected net farm income than in 2005 contributed to the slide in the credit climate, especially with District dairy producers struggling. Also, some bankers viewed smaller government payments than those from a year ago as a factor. Respondents indicated that non-real-estate farm loan repayment rates were down from the previous year. With 6 percent of the bankers reporting higher rates of loan repayment and 19 percent reporting lower rates, the index of loan repayment rates was 87 (see table on the next page). Moreover, loan renewals and extensions were higher than those in the third quarter of 2005, with 22 percent of the bankers indicating an increase and 7 percent indicating a decrease. There were comments that marginal operators had trouble paying off 2005 operating loans. Only Indiana did not exhibit slippage in loan repayment rates, nor did it show higher levels of renewals and extensions.

In addition, fund availability experienced a dip similar to a year ago, only the second decline in almost six years. With 13 percent of the bankers reporting they had more funds available during July, August, and September than they had a year earlier and 18 percent reporting they had less, the index of fund availability was 95. Collateral requirements at District banks stiffened a bit less than last quarter, with 9 percent requiring more collateral.

2. Quarterly District farm loan interest rates

percent



338.13
A46
1934

Credit conditions at Seventh District agricultural banks

	Loan demand (index) ²	Fund availability (index) ²	Loan repayment rates (index) ²	Average loan-to-deposit ratio (percent)	Interest rates on farm loans		
					Operating loans ¹ (percent)	Feeder cattle ¹ (percent)	Real estate ¹ (percent)
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
2006							
Jan-Mar	131	102	87	76.7	8.30	8.27	7.48
Apr-June	115	101	85	78.0	8.76	8.66	7.85
July-Sept	124	95	87	79.1	8.73	8.70	7.82

Note: Historical data on credit conditions at Seventh District agricultural banks is available for download as a spreadsheet from the AgLetter homepage, http://www.chicagofed.org/economic_research_and_data/ag_letter.cfm.

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.

Demand for non-real-estate loans grew for the eleventh consecutive quarter. With 38 percent of the bankers reporting higher demand for non-real-estate loans from a year earlier and 13 percent reporting a decline in demand, the index of loan demand was 124, the second highest value since 1998. In contrast with the rest of the District, Michigan and Wisconsin had more reports of lower demand for non-real-estate loans than reports of higher demand.

Interest rates on agricultural loans leveled off after two and a half years of increases (see chart 2 and table above). As of October 1, the District average for interest rates on new operating loans was 8.73 percent, slightly less than last quarter. Interest rates on operating loans ranged from 8.47 percent in Illinois to 9.15 percent in Michigan. Interest rates for farm real estate loans averaged 7.82 percent. Iowa had the lowest rate for farm mortgages, 7.65 percent, and Michigan had the highest rate, 8.46 percent.

The District loan-to-deposit ratio was 79.1 percent, setting another record. The percentage of banks that reported being above their desired loan-to-deposit ratio was 24 percent versus 46 percent being below. Iowa had a third of its banks above their desired loan-to-deposit ratio, the highest ratio in the District.

Looking forward

Credit conditions during the fall and winter seemed primed to worsen, though not everywhere in the District. Respondents expected the volume of farm loan repayments to decrease over the next three to six months compared with a year ago, primarily in Michigan and Wisconsin (14 percent and 34 percent more responded down versus up, respectively). About the same percentage of bankers expected an increase versus a decrease in forced sales or liquidation of farm assets among financially stressed

farmers. However, this masks distress in Wisconsin, where 26 percent anticipated higher levels of forced sales or asset liquidation and none anticipated lower levels.

In the fourth quarter of 2006, 30 percent of the bankers expected higher non-real-estate loan volume and 12 percent expected lower volume than in 2005. Respondents predicted increases in operating loans (41 percent more forecasted increases rather than decreases), grain storage construction loans (17 percent), and Farm Service Agency guaranteed loans (11 percent). More bankers anticipated higher (21 percent) rather than lower (13 percent) real estate loan volume. The story for Michigan and Wisconsin on expected farm loan volume differed from the rest of the District, reinforcing a pattern that dominated the current survey results.

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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)	October	117	-1.7	5	3
Crops (index, 1990-92=100)	October	116	-4.9	13	5
Corn (\$ per bu.)	October	2.72	23.6	49	27
Hay (\$ per ton)	October	107.00	0.0	10	15
Soybeans (\$ per bu.)	October	5.46	4.2	-4	-2
Wheat (\$ per bu.)	October	4.65	14.5	36	36
Livestock and products (index, 1990-92=100)	October	117	0.0	-4	-1
Barrow and gilts (\$ per cwt.)	October	47.60	-3.8	1	-10
Steers and heifers (\$ per cwt.)	October	94.4	-1.5	-2	4
Milk (\$ per cwt.)	October	13.3	3.1	-15	-15
Eggs (¢ per doz.)	October	56.7	1.3	11	18
Consumer prices (index, 1982-84=100)	October	202	-0.5	1	6
Food	October	197	0.5	3	5
Production or stocks					
Corn stocks (mil. bu.)	September 1	1,971	N.A.	-7	106
Soybean stocks (mil. bu.)	September 1	449	N.A.	75	301
Wheat stocks (mil. bu.)	September 1	1,743	N.A.	-9	-10
Beef production (bil. lb.)	September	2.16	-11.5	0	3
Pork production (bil. lb.)	September	1.74	-1.7	0	-2
Milk production (bil. lb.)*	October	13.7	2.6	2	6
Agricultural exports (mil. dol.)	September	5,315	-1.8	16	16
Corn (mil. bu.)	September	197	-12.3	49	19
Soybeans (mil. bu.)	August	51	7.1	81	372
Wheat (mil. bu.)	August	80	15.6	-6	-23
Farm machinery (units)					
Tractors, 40 HP and over	October	9,625	39.3	0	-5
40 to 100 HP	October	7,109	21.2	4	5
100 HP and over	October	2,516	141.0	-11	-26
Combines	October	637	-21.1	18	-42

N.A. Not applicable

*23 selected states.

Sources: Data from the U.S. Department of Agriculture, U.S. Bureau of Labor Statistics, and the Association of Equipment Manufacturers.

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