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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

With bumper crops supporting farm income, stronger demand for farmland once again was expected to follow higher gains in the value of "good" agricultural land for the Seventh Federal Reserve District. Based on a survey of around 290 agricultural bankers as of October 1, 2004, the quarterly rise in farmland values was 3 percent, on average, for the entire District. An average increase of 12 percent for the twelve months ending September 30 topped all annual results in the last decade and a half. Almost half of the responding bankers expected land values to continue to rise and nearly half expected them to be stable.

Agricultural credit conditions brightened compared to a year ago as reported by District bankers. In the third quarter, loan demand and the availability of funds were above the levels of the previous year. Though loan repayment rates in the District increased from a year earlier, the increase was less than reported so far in 2004. A small proportion of banks required higher collateral, while over 90 percent did not change their collateral requirements. Renewals and extensions of loans declined in the third quarter relative to a year earlier, according to the respondents. Average interest rates on agricultural loans rose again to the highest levels since early 2003. Loan-to-deposit ratios continued moving up, approaching the level of two years ago, but were 4 percent below the ratio desired by the bankers. Farm income has risen to record levels in the U.S., and improved agricultural credit conditions in the District reflect this phenomenon.

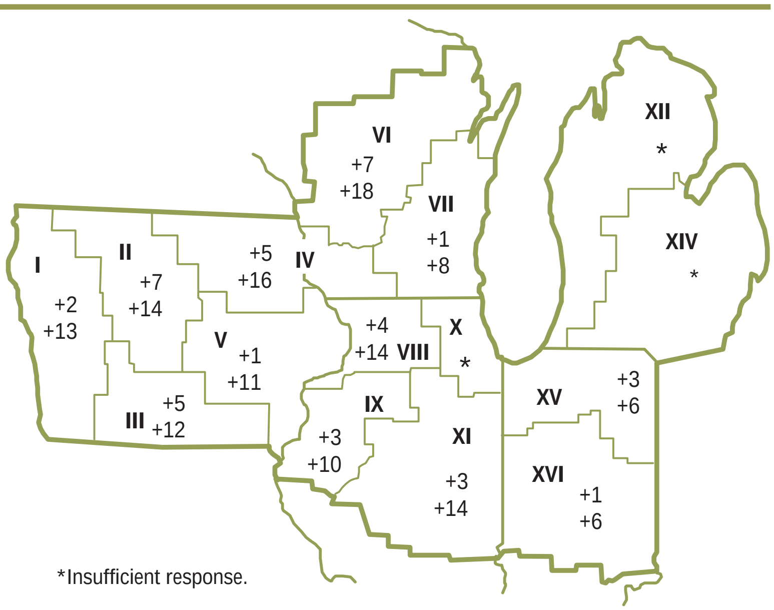
Farmland values

The value of "good" agricultural land rose at a faster pace in the third quarter of 2004. Differences among District states (see map and table below) were not as large as during the previous quarter. Illinois and Wisconsin saw the biggest gains in land values, followed by Iowa, while increases in Indiana and Michigan trailed the District average from July 1 to October 1. With the District corn harvest increasing 15 percent from 2003 and soybean production up 37 percent, increased farmland values reflected record yields in many parts of the District. Farmland value gains in Indiana were half of those experienced in Illinois and Iowa, even with the second largest crop production increase after Iowa. One explanation for slower growth in farmland values for Indiana, and possibly Michigan, could be that there was relatively less pressure from development of farmland. Wisconsin had a higher proportion of late-planted crops which dampened output growth, but still saw a

Percent change in dollar value of "good" farmland

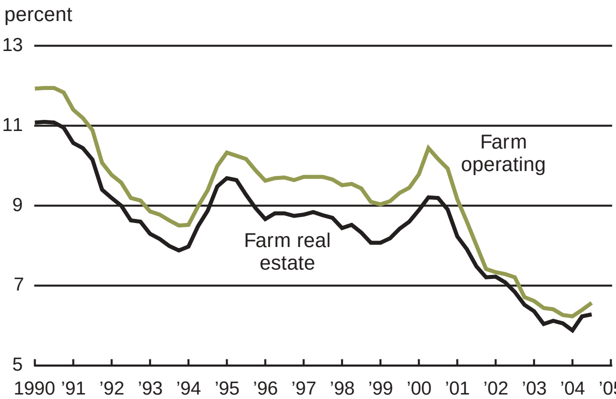
Top: July 1, 2004 to October 1, 2004
Bottom: October 1, 2003 to October 1, 2004

	July 1, 2004 to October 1, 2004	October 1, 2003 to October 1, 2004
Illinois	+4	+14
Indiana	+2	+6
Iowa	+4	+13
Michigan	+2	+9
Wisconsin	+5	+14
Seventh District	+3	+12



*Insufficient response.

Quarterly District farm loan interest rates



5 percent increase in farmland values for the third quarter, possibly linked to recreational usage of farmland and the recovery of dairy prices.

The year-over-year increase in District farmland values averaged 12 percent for the quarter, only matched once in 1996 during the last 15 years. The increases ranged from a 6 percent gain in Indiana to 14 percent gains in Illinois and Wisconsin, closely followed by Iowa at 12 percent.

Even with the year-over-year increase up substantially from last year, almost no bankers expected farmland values to go down and almost half expected farmland values to rise in the next three months. Only in Michigan did significantly less than half expect farmland values to rise during the next three months, though the majority expected stable values. These expected gains stem at least partly from rising demand by both farmers and nonfarm investors. Demand from the nonfarm sector was anticipated to rise this fall and winter compared to a year ago according to 72 percent of the respondents (only 5 percent pegged this demand to go down). Nonfarm demand would seem to be outstripping demand from farmers, as 46 percent of respondents predicted higher demand from farmers and 13 percent thought it would go down. Iowa bankers had the strongest expectations for higher demand, but bankers from all District states forecast significantly heightened nonfarm demand and at least somewhat higher demand from farmers. Almost half of the responding bankers anticipated the volume of farmland transfers to move up as well during the fall and winter, especially in Illinois and Iowa.

Credit conditions

Agricultural credit conditions improved in the third quarter of 2004, even as interest rates continued to rise. More respondents (25 percent) reported higher demand for non-real-estate loans from a year earlier than reported a decline (17 percent). This raised the index of loan demand to 109 (see table on page 3), up a bit from last quarter. Indiana and Iowa experienced the strongest demand for non-real-estate loans, whereas demand weakened from a year ago in Michigan and Wisconsin. Higher and lower demand offset each other in Illinois. Fund availability was up from a year ago, but not as vigorously as earlier in the year. With 23 percent of the bankers reporting they had more funds available during July, August, and September than they had a year earlier and 12 percent with less, the index of fund availability was 111, the smallest value in three years. All District states reported improved funds availability, with the lowest index for Indiana (103).

Bankers indicated that non-real-estate farm loan repayment rates had improved from last year, just before a year-long streak of improvements fueled by higher agricultural prices. As 19 percent of the respondents reported higher rates of loan repayment and 7 percent reported lower rates, the index of loan repayment rates was 112, the lowest of the year. Furthermore, loan renewals and extensions fell from a year ago, with just 8 percent of the bankers noting an increase, and 21 percent noting a decrease. All the states in the District had higher levels of loan repayments, and none had higher levels of renewals and extensions. Most notably, almost a third of the Wisconsin bankers responded that renewals and extensions had gone down and for the rest they were unchanged. Collateral requirements at District banks tightened slightly, with 8 percent requiring a higher level of collateral in the past three months.

The District loan-to-deposit ratio edged up to 74.5 percent, the highest in two years. Again Illinois (66.5 percent) was the lone state below the District average. Illinois banks averaged 6 percentage points below their desired levels, the widest gap among District states. The percentage of banks that reported being above their desired loan-to-deposit ratio was 17 percent, compared to 14 percent a year earlier.

Once again banks noted that farm loan interest rates had increased and were now at the highest levels in a year and a half (see chart and table). As of October 1, the District average for interest rates on new operating loans was up to 6.57 percent, 35 basis points above the cyclical low in March. Interest rates on operating loans ranged from 6.27 percent in Illinois to 6.81 percent in Iowa, on average. At an average of 6.28 percent, interest rates for farm mortgages rose 41 basis points over the past two quarters. For farm real estate loans, again Illinois had the lowest rate, 6.19 percent, and Michigan had the highest rate, 6.61 percent (30 basis points above any other state). Several respondents commented that in a rising interest rate environment expectations were for slower growth in farmland values going forward.

Looking forward

Setting the stage for even better credit conditions, the USDA forecast a record U.S. net farm income for 2004 ($73.7 billion, an increase of 25 percent over the previous record of 2003) as both crop and livestock producers saw higher margins.

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
July-Sept	109	111	112	74.5	6.57	6.61	6.28

[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.

The bumper harvest of corn and soybeans combined with government payments have helped to offset the price declines for crop producers plus higher fuel and fertilizer costs. Lower feed costs have helped dairy and livestock producers, while dairy and meat prices have remained higher than many anticipated.

Survey results for the District supported further increases in net farm earnings over the next three to six months compared to a year earlier. Less than a fifth of respondents foresaw lower net farm earnings, while over half expected higher net farm earnings for crop, cattle, and hog farmers and a third for dairy farmers. As the only departures from increases, Wisconsin bankers thought net income from crops would be a bit lower, and Michigan bankers saw dairy net income dropping. But still, respondents in all states expected the volume of farm loan repayments to rise rather than fall over the fall and winter, particularly in Indiana. Moreover, in contrast to last year at this time, fewer bankers (4 percent) expected an increase in forced sales or liquidation of farm assets among financially stressed farmers and 30 percent expected a decrease.

For the fourth quarter of 2004 compared with the fourth quarter a year ago, 27 percent of the respondents expected higher non-real-estate loan volume. Just 13 percent expected lower volume for the District, but these bankers outnumbered those expecting gains in Michigan and Wisconsin. Bankers anticipated increases in operating loans (31 percent), farm machinery loans (39 percent), and grain storage construction loans (22 percent). Once again Michigan and Wisconsin bucked the pattern, though 10 percent more bankers in Wisconsin expected an increase in farm machinery loans versus a decline. Except for Indiana, Farm Service Agency (FSA) guaranteed loans were thought to be in for a small decrease. With 26 percent foreseeing higher real estate loan volume and 11 percent foreseeing lower volume there was a shift in expectations from a year ago, but similar expectations as last quarter. On balance bankers in Illinois, Indiana, and Iowa anticipated higher activity for farm real estate loans, whereas their counterparts in Michigan and Wisconsin saw the reverse.

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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	111	–3.5	–2	17
Crops (*index, 1990-92=100*)	October	106	–5.4	–5	5
Corn *($ per bu.*)	October	1.89	–14.1	–11	–19
Hay *($ per ton*)	October	89.80	2.4	7	–4
Soybeans *($ per bu.*)	October	5.07	–13.2	–23	–3
Wheat *($ per bu.*)	October	3.38	0.6	–2	–23
Livestock and products (*index, 1990-92=100*)	October	117	–0.8	1	34
Barrow and gilts *($ per cwt.*)	October	52.10	–6.0	41	66
Steers and heifers *($ per cwt.*)	October	91.1	2.0	–7	33
Milk *($ per cwt.*)	October	15.5	0.6	3	28
Eggs (*¢ per doz.*)	October	50.3	–7.5	–40	–5
Consumer prices (*index, 1982-84=100*)	October	191	0.5	3	5
Food	October	188	0.6	3	6
Production or stocks					
Corn stocks (*mil. bu.*)	September 1	958	N.A.	–12	–40
Soybean stocks (*mil. bu.*)	September 1	112	N.A.	–37	–46
Wheat stocks (*mil. bu.*)	September 1	1,942	N.A.	–5	11
Beef production (*bil. lb.*)	October	2.11	0.5	–4	–16
Pork production *(bil. lb.)*	October	1.78	0.4	–7	–3
Milk production* *(bil. lb.)*	October	12.2	3.1	1	2
Receipts from farm marketings *(mil. dol.)*	July	18,997	–3.4	8	16
Crops**	July	8,762	4.2	4	8
Livestock	July	10,235	–9.1	12	23
Agricultural exports *(mil. dol.)*	September	4,569	8.4	4	16
Corn *(mil. bu.)*	September	162	6.0	13	35
Soybeans *(mil. bu.)*	August	11	–27.0	–69	–72
Wheat *(mil. bu.)*	September	121	16.2	–4	61
Farm machinery *(units)*					
Tractors, over 40 HP	October	10,238	44.1	21	39
40 to 100 HP	October	6,812	17.2	17	36
100 HP or more	October	3,426	164.1	30	44
Combines	October	1,097	10.7	103	41

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