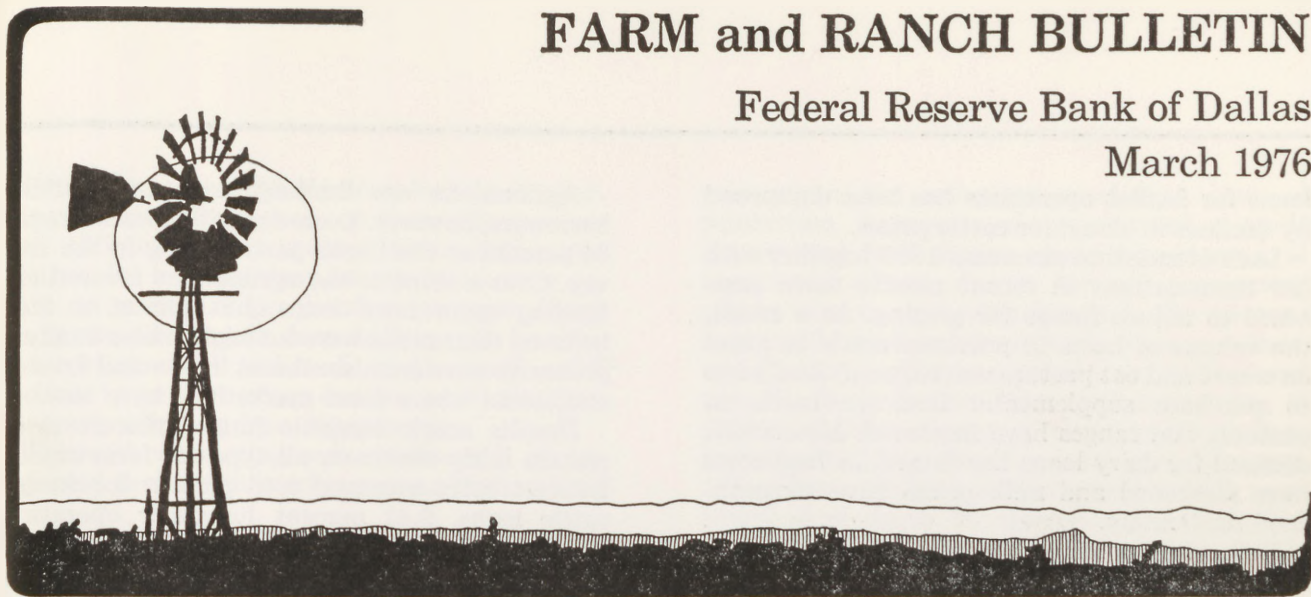


FARM and RANCH BULLETIN

Federal Reserve Bank of Dallas

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STRONG DEMAND FOR FARM LOANS REFLECTS HIGHER COSTS

Bolstered by rising operating expenses, increasing machinery costs, and expanding numbers of cattle on feed, demand for agricultural loans at commercial banks was strong at the beginning of 1976. Rates of loan repayment were sluggish, and extensions remained high. Meanwhile, ample funds were available for loans to farmers and ranchers.

Results of a Federal Reserve Bank of Dallas survey of more than 230 bankers actively involved in farm financing showed that agribankers remained selective in their lending because of the uncertainties of markets and weather. Lending arrangements were being made with qualified borrowers that had adequate security.

Costs climb

Agribankers in the Eleventh District reported that as of January 1, demand for non-real-estate farm loans was above average. Demand for loans was strongest in major crop-producing areas of Texas—the High and Low Rolling Plains, the Coastal Prairies, and South Texas—northern Louisiana, and New Mexico. Demand was weakest in ranching areas.

Demand for crop operating loans was stronger than usual because of high and increasing costs of farm inputs—such as fuel, repairs, labor, and replacement parts. Average prices farmers paid for production items in January were 6 percent higher than a year earlier. Moreover, with dry weather affecting most of the District, increased irrigation costs will probably enlarge operating loans. And the demand for crop storage loans—particularly in the northern and southern High Plains of Texas and in Louisiana—was above normal, as producers retain ownership of their crops because of the general downtrend in soybean and grain prices. Some agribankers expressed concern that low prices for these commodities could limit producers' incomes to near a break-even situation.

Enhanced by lower feed costs and favorable slaughter prices last fall, demand for cattle feeding loans increased significantly in the Texas High Plains feedlot area. Placements of cattle on feed expanded rapidly late last year, and the number of cattle on feed in Texas on January 1 was about 42 percent higher than a year earlier. But since the beginning of this year, demand for

loans for feedlot operations has been dampened by declines in slaughter cattle prices.

Lack of moisture since mid-1975 together with low temperatures in recent months have combined to reduce forage for grazing. As a result, the volume of loans to purchase cattle to graze on wheat and oat pasture was reduced. And loans to purchase supplemental feed for cattle in pastures and ranges have increased. Meanwhile, demand for dairy loans has firmed, as feed costs have slackened and milk prices have strengthened moderately.

Reflecting higher prices, the dollar volume of farm machinery loans was expected to increase slightly during the first three months of this year. Prices U.S. farmers paid for machinery at the beginning of this year were up about 20 percent over a year earlier. In the southern High Plains of Texas, however, low cotton yields will dampen the demand for farm machinery loans.

Loan repayments at commercial banks in the Eleventh District were below average, largely because of developments in cattle markets. Cow-calf operators across the Southwest have been plagued by depressed prices for feeder and stocker cattle during the past two years. And with rising costs of production and limited moisture, many cattlemen, have encountered difficulty repaying loans. This has pushed up renewals and extensions.

Crop farmers also have faced problems repaying loans, as adverse weather together with a cost-price squeeze reduced incomes in 1975. In Louisiana, farmers have suffered back-to-back crop failures, restricting their ability to repay loans and causing renewals and extensions to exceed average levels.

Funds abound

With ample funds available, almost 50 percent of the survey respondents reported they were seeking new farm loan accounts. And only 8 percent of the respondents indicated a shortage of funds was causing loans to be either reduced or refused.

Agribankers are limiting loans to qualified borrowers, however. Loan-deposit ratios averaged 54 percent at the banks participating in the survey. Over a third of the agribankers favored extending more farm loans, but almost a fifth believed their ratios were too high. These bankers primarily were from southeast Texas and Louisiana, areas where farm marketings have slowed.

Despite ample loanable funds, interest rates remain fairly stable on all types of farm credit. Interest rates averaged 9.46 percent for feeder cattle loans, 9.42 percent for other operating loans, 9.42 percent for intermediate-term loans, and 9.36 percent for long-term farm real estate loans.

Bankers reported that with declining grain prices and the depressed cow-calf industry, demand for farm real estate loans had stabilized. Agribankers in New Mexico, Louisiana, and the southern High Plains of Texas, however, indicated land values will continue to increase moderately. Average market values for representative farmland and ranchland with average productivity in the Eleventh District were \$384 an acre for dryland, \$648 an acre for irrigated land, and \$284 an acre for ranchland.

Strategies emerge

Increasing costs of producing food and fiber and the uncertainty of changing market conditions have caused both borrowers and lenders to seek new methods of minimizing the risks of product price fluctuations. The constantly changing conditions that affect agricultural financing place a premium on sound planning and decision-making for such volatile factors as capital, credit, and markets.

Several management strategies—hedging, forward contracting, and systematic marketing—are open to lenders and borrowers. Effective use of these techniques requires keeping informed on developments in local, national, and world agriculture and in business and banking.

Hedging is used to lessen risks of price fluctuations in agricultural commodities. It permits

producers to preestablish prices, locking in operating margins. Producers can then plan production and investment outlays to maximize net returns. By hedging, farmers can also earn a return on stored crops. Lenders of agricultural credit can also benefit from hedging. As production costs increase and credit needs climb, small declines in product prices dampen profit margins, adversely affecting loan repayments.

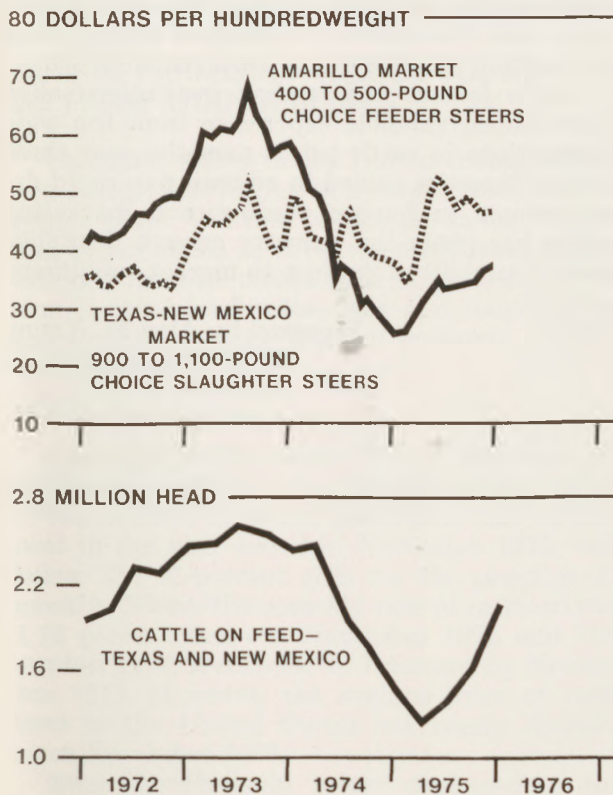
Forward contracting reduces the risk of unexpected declines in market prices. With a fixed

price above the estimated break-even costs of production, borrowers are guaranteed a profit margin and lenders are reasonably assured of repayments. Even though forward contracting can be used in marketing livestock, the strategy is generally used in sales of such crops as cotton, wheat, corn, sorghum, soybeans, vegetables, and rice. A disadvantage of forward contracting is that an established price prevents producers from making windfall profits if product prices increase.

Another strategy is systematic or orderly marketing of products. By spreading the marketing of crop and livestock products over longer periods of time, producers aim for favorable average prices for their products, minimizing the risk of wide fluctuations.

Keeping records of farming operations and marketing information is an important managerial tool. Financial and production records—income statements, balance sheets, cash flows, and cost-return budgets—help borrowers and lenders make decisions. And up-to-date records and knowledge of agricultural market developments aids the decision-making process. On balance, knowledge and effective use of these and other tools will improve the evaluation and establishment of credit arrangements for farm and ranch loans.

STEER PRICES AND CATTLE ON FEED



SOURCE: U.S. Department of Agriculture

BANKS MAIN SUPPLIERS OF CATTLE FEEDING LOANS

Cattle in feedlots in Texas and New Mexico generally are locally owned and financed, according to a survey of commercial bankers in cattle feeding areas of the two states. Feedlot owners, local ranchers, and individuals each own about 25 percent of the cattle on feed. Absentee investors, cattle clubs, and other investors account for the remaining 25 percent.

Bankers participating in the survey reported local banks supply nearly half of the credit used in feeding operations and correspondent banks furnish another tenth. Production credit associations provide about a third of the funds, and other sources the rest.

Equity requirements for cattle feeding loans average about 30 percent. In other words, loans cover about 70 percent of the estimated cost of feeder cattle and feed. As an example, if 600-pound feeder calves sold for 35 cents a pound, and 400 pounds of gain cost 45 cents a pound, capital needs for an animal would total \$390. Under the current equity guidelines, therefore, borrowers would provide about \$117 in equity, and lenders about \$273 of credit for the animal.

The number of cattle on feed in Texas and New Mexico at the beginning of 1976 totaled almost 2.1 million head, the highest since April 1974. Feeding in January was two-thirds higher than the six-year low in April 1975 but slightly less than the record high in July 1973.

Part of the turnaround in the cattle feeding industry stems from lower feed prices and the long-awaited return to profitability in the last half of 1975. But some of the increase also stems from devastation to the winter wheat crop, which has been hit hard by drought. Lack of grazing has forced producers to place many lightweight animals on feed.

These cattle are entering a market significantly different from a few years earlier. High grain prices since 1973 have pushed the cost per pound of gain in the feedlot above the price per pound of fattened cattle. In past years, when feed was relatively inexpensive, profits in feeding cattle were made by selling grain-fed cattle for more than the cost of gain. Buyers, therefore, could pay more per pound for cattle going into feedlots than they received for grain-fed cattle. Today, however, increased feed costs have forced the price of cattle going into feedlots below the price of cattle coming out.

Uncertainties surrounding the cost of grain and the market price for slaughter cattle are being closely evaluated by both cattle feeders and lenders. A majority of the bankers reported they were encouraging borrowers to hedge their investment in cattle feeding, thus reducing the financial risk of a sharp drop in market prices. By contrast, five years ago few bankers encouraged

hedging to protect loans. They noted, however, that futures prices often are below the break-even price of grain-fed cattle, making hedging impractical at those times.

Profit margins narrowed early this year, causing some feeders to rush cattle to market in an effort to make a small profit. The market dropped further, and in late January the cost per pound of gain of cattle marketed averaged close to 45 cents while grain-fed cattle prices averaged about 39 cents. Most cattle feeders, consequently, were suffering substantial losses per head.

Despite the cattle feeding industry's financial squeeze, most of the survey respondents expressed optimism that the industry will remain economically sound in 1976. They noted that even with the decline in slaughter cattle prices in January, placements on feed remain high.

Cattle feeders and lending institutions alike have gained valuable experience from the wide fluctuations in cattle prices over the past three years. Expertise gained in adjusting to rapid developments in buying, feeding, and marketing cattle has given the industry enough flexibility and adaptability to adjust to market conditions.

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