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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary
Despite continued increases in the value of "good" agricultural land for the Seventh Federal Reserve District, agricultural bankers painted a gloomier picture of credit conditions. The survey results for 262 agricultural bankers as of October 1, 2005, showed a quarterly gain in farmland values of 3 percent for the District. The 11 percent rise in farmland values for the twelve months ending September 30 remained close to the highest of the last 25 years. A third of the responding bankers expected land values to increase in the fourth quarter of 2005.

Agricultural credit conditions in the third quarter of 2005 deteriorated from a year ago according to District bankers. Loan repayment rates in the District fell below the levels of a year ago, the first decline in two years. Renewals and extensions of loans increased in the third quarter relative to a year earlier. The proportion of banks requiring more collateral was larger than in recent quarters, with 86 percent of respondents keeping collateral requirements unchanged. Moreover, the availability of funds was less than the previous year for the first time since 2000, though loan demand rose compared to a year ago. Average interest rates on agricultural loans increased again, still more than 200 basis points lower than the most recent cyclical peak in 2000. The average loan-to-deposit ratio inched up, equaling the high set in 2000, but was 3.3 percent below the ratio desired by respondents.

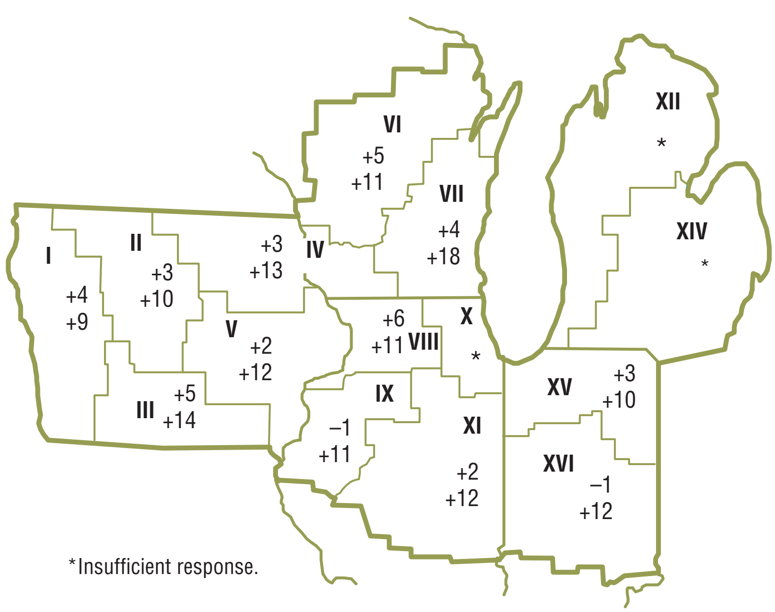
Farmland values
The value of "good" agricultural land in the District continued to climb in the third quarter of 2005, rising 3 percent for the quarter. The quarterly results for District states (see map and table below) varied from no gain in Indiana to 4 percent gains in Iowa and Wisconsin. Bankers continued to comment on the key role tax deferred exchanges play in boosting farmland values. The year-over-year increase in District farmland values averaged 11 percent. Wisconsin had the largest gains in land values, closely followed by Illinois, Indiana, and Iowa. Michigan farmland values increased the least, reflecting greater economic distress relative to other District states. Consequently, Michigan's slower growth in farmland values was due in part to less pressure from development.

The proportion of respondents expecting farmland values to go up in the next three months declined to a third. Only in Wisconsin did more than a third (45 percent) expect farmland values to rise during the fourth quarter of 2005. Overall, almost two-thirds anticipated that farmland values will be stable from October to December.

Percent change in dollar value of "good" farmland

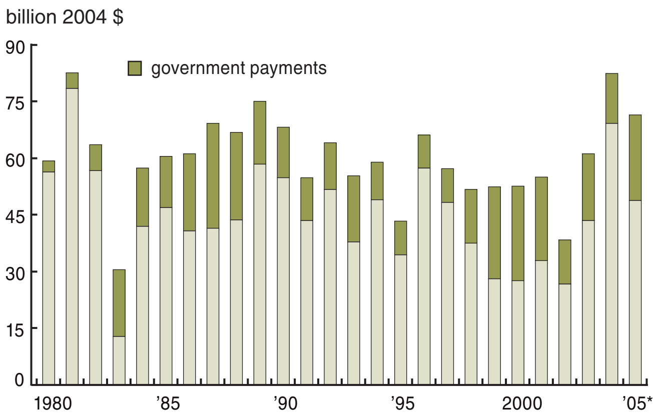
Top: July 1, 2005 to October 1, 2005
Bottom: October 1, 2004 to October 1, 2005

	July 1, 2005 to October 1, 2005	October 1, 2004 to October 1, 2005
Illinois	+3	+12
Indiana	0	+11
Iowa	+4	+11
Michigan	+3	+4
Wisconsin	+4	+14
Seventh District	+3	+11



*Insufficient response.

1. Real net farm income



*Projected.
Source: Data from USDA.

Strong demand for farmland among nonfarm investors remained the dominant factor producing these expected increases, even as demand among farmers cooled. More respondents thought interest by nonfarm investors to acquire farmland will rise rather than fall (57 percent versus 9 percent) over the next three to six months. However, 5 percent more bankers expected demand among farmers to go down than up, with about half seeing farmer demand unchanged. This perception was strongest in Illinois, possibly because of lower corn and soybean yields due to drought. In contrast, Indiana and Wisconsin respondents had expectations for higher demand by farmers. Half of the responding bankers anticipated the volume of farmland transfers to remain unchanged during the fall and winter, while almost 40 percent expected higher volumes of transfers (especially in Illinois).

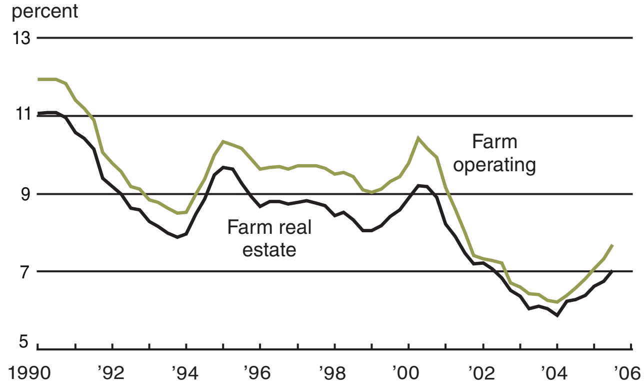
One explanation for the lower interest among farmers to acquire farmland this fall and winter relates to the drop in net farm income from the record set in 2004 (see chart 1). The U.S. Department of Agriculture (USDA) estimated that net farm income this year will be $71.5 billion, down $11 billion from last year. The decrease is primarily due to lower crop production, combined with some lower crop prices. For District states the corn harvest was forecast to be 5.48 billion bushels this year, 7 percent below 2004's record. District production of soybeans was estimated at 1.37 billion bushels, a 3 percent decline from last year's record harvest. Survey results for the District echoed the USDA forecasts, as over 60 percent of the respondents expected decreased net cash farm earnings over the next three to six months compared with a year earlier for crop farmers. About 10 percent more respondents expected higher rather than lower net cash farm earnings for cattle and hog producers, while the split was essentially even for dairy farmers. Illinois respondents said that the state faces the bleakest net cash income forecast with over 80 percent seeing declines from crops, without much prospect of livestock increases. Government payments helped compensate for the loss of market income, increasing by $13.3 billion from disbursements in 2004. The stream of government payments has also contributed to the increases of farmland values.

Credit conditions

Most measures of credit conditions worsened in the third quarter of 2005. A primary factor in this reversal from a year ago is the predicted decline in net farm income. Yet, even when adjusted for inflation, net farm income in 2005 will be higher than almost all years prior to 2004. Still, bankers indicated that non-real-estate farm loan repayment rates fell from last year, ending a string of improvements fueled by higher agricultural prices and output. With 6 percent of the respondents reporting higher rates of loan repayment and 18 percent reporting lower rates, the index of loan repayment rates was 87, the first dip below 100 in two years (see table on the next page). Furthermore, loan renewals and extensions were up from a year ago, with 22 percent of the bankers indicating an increase and 5 percent indicating a decrease. Only Wisconsin had higher levels of loan repayments and lower levels of renewals and extensions. Wisconsin may have bucked the trend toward worsening credit conditions due to increases of over 20 percent in corn and soybean production compared with 2004, as well as a more diversified agricultural sector.

Collateral requirements at District banks tightened more than in recent quarters, with 13 percent requiring a higher level of collateral in the past three months. Moreover, fund availability was down from a year ago, for the first time in over four years. With 15 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 97.

2. Quarterly District farm loan interest rates



Credit conditions at Seventh District agricultural banks

	Loan demand	Fund 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

[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.

Non-real-estate loan demand rose again for the seventh quarter in a row. More respondents (30 percent) reported higher demand for non-real-estate loans from a year earlier than reported a decline in demand (15 percent). This set the index of loan demand at 115, down a bit from last quarter. Iowa, followed by Illinois and Indiana, experienced the strongest demand for non-real-estate loans.

Farm loan interest rates increased again (see chart 2 and table above). As of October 1, the District average for interest rates on new operating loans rose to 7.68 percent, the highest level in four years. Interest rates on operating loans ranged from 7.36 percent in Illinois to 7.86 percent in Iowa. At 7.02 percent, interest rates for farm mortgages were at the highest level in over three years. For farm real estate loans, Illinois again had the lowest rate, 6.89 percent, and Wisconsin had the highest rate, 7.29 percent.

The District loan-to-deposit ratio was 76.9 percent, matching the highest ever reading in 2000. Illinois (68.1 percent) pulled down the District average, as the other states were near 80 percent or above. The percentage of banks that reported being above their desired loan-to-deposit ratio was 18 percent versus 47 percent below.

Looking forward

Responding bankers do not foresee improvement in credit conditions over the fall and winter. In contrast with last year at this time, more bankers (21 percent) expected an increase in forced sales or liquidation of farm assets among financially stressed farmers than expected a decrease (9 percent). These concerns were voiced by 35 percent more Illinois bankers, with almost 60 anticipating no change. In addition, respondents in all states expected the volume of farm loan repayments to decrease over the fall and winter, particularly in Illinois.

For the period covering October, November, and December of 2005 compared with the same period last year, 33 percent of the respondents expected higher non-real-estate loan volume. Only 10 percent expected lower volume for the District. Bankers anticipated increases in operating loans (49 percent), grain storage construction loans (23 percent), and Farm Service Agency (FSA) guaranteed loans (26 percent). Given recent increases in input costs and the piles of grain stored outdoors, these results are not surprising. Only in Indiana did more bankers foresee higher rather than lower real estate loan volume in the fourth quarter of 2005.

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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	110	–6.0	–4	–3
Crops *(index, 1990–92=100)*	October	101	–9.8	–9	–9
Corn *($ per bu.)*	October	1.74	–8.4	–19	–18
Hay *($ per ton)*	October	97.70	–1.3	5	17
Soybeans *($ per bu.)*	October	5.44	–5.7	–2	–18
Wheat *($ per bu.)*	October	3.54	5.7	3	3
Livestock and products *(index, 1990–92=100)*	October	122	0.0	3	5
Barrow and gilts *($ per cwt.)*	October	49.10	–1.6	–7	33
Steers and heifers *($ per cwt.)*	October	96.0	4.0	5	–2
Milk *($ per cwt.)*	October	15.4	0.7	–1	3
Eggs (¢ per doz.)	October	53.4	–21.9	11	–36
Consumer prices *(index, 1982–84=100)*	October	199	0.2	4	8
Food	October	192	0.4	2	6
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	2,112	N.A.	120	94
Soybean stocks *(mil. bu.)*	September 1	256	N.A.	129	44
Wheat stocks *(mil. bu.)*	September 1	1,919	N.A.	–1	–6
Beef production *(bil. lb.)*	September	2.16	–6.9	3	–7
Pork production *(bil. lb.)*	September	1.74	–0.5	–2	4
Milk production *(bil. lb.)**	October	13.4	2.7	4	–4
Receipts from farm marketings *(mil. dol.)*	June	17,101	–2.9	–9	10
Crops**	June	7,370	7.3	–1	–4
Livestock	June	9,731	–9.4	–14	24
Agricultural exports *(mil. dol.)*	September	4,581	–5.5	0	4
Corn *(mil. bu.)*	August	146	1.2	–5	14
Soybeans *(mil. bu.)*	August	30	51.5	181	–12
Wheat *(mil. bu.)*	August	85	–7.1	–18	–29
Farm machinery *(units)*					
Tractors, over 40 HP	October	9,760	26.4	–4	15
40 to 100 HP	October	6,901	10.2	2	18
100 HP or more	October	2,859	96.6	–16	8
Combines	October	549	–55.5	–50	1

N.A. Not applicable
*23 selected states.
**Includes net CCC loans.
Source: Data from USDA, U.S. Bureau of Labor Statistics, and the Association of Equipment Manufacturers.