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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary
Demand to purchase farmland grew last quarter, especially among nonfarm investors, contributing to the increase in the value of "good" agricultural land for the Seventh Federal Reserve District. Based on a survey of more than 360 agricultural bankers as of October 1, 2002, the quarterly increase in farmland values rose to 2 percent, on average, for the District as a whole. For the twelve months ending September 30 the increase was 7 percent. The year-over-year increase exceeded that of last year. Looking ahead, more bankers expected farmland values to go up and fewer expected farmland values to decline in the next three months.

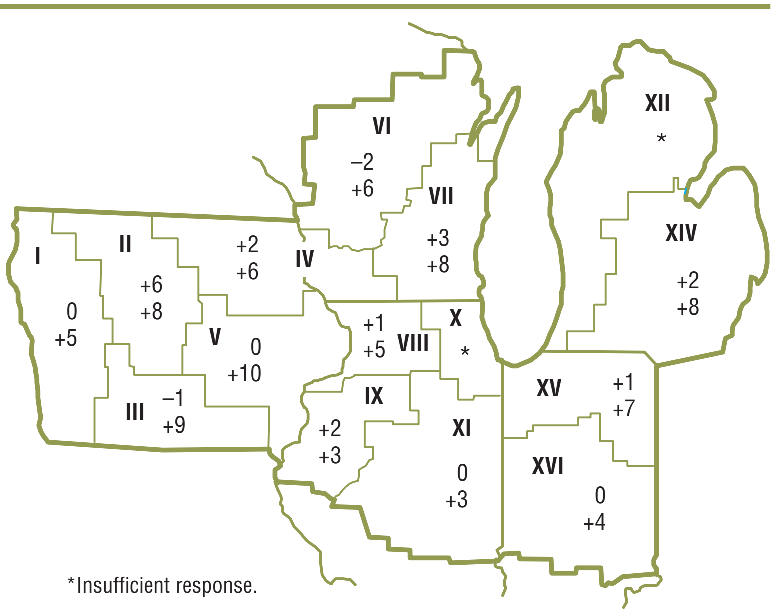
There has been some deterioration in agricultural credit conditions from a year ago according to District bankers. In the third quarter, although the availability of funds was greater than last quarter but down slightly from a year ago, demand for loans was unchanged. However, a larger proportion of banks required increased collateral, which may have constrained demand. More renewals and extensions of loans were generated in the third quarter than a year earlier, according to the respondents. Even with an improvement from last quarter, the rate of loan repayment declined from the previous year in all District states, reinforcing growing concern about financial stress in the agricultural economy. Interest rates on agricultural loans dropped across the District again, the ninth quarterly drop in a row. Loan-to-deposit ratios climbed to the highest average in two years, still about 3 percent below the average the bankers reported as their desired ratio. Hence, there are a few positive signs mixed with the signs of deterioration in agricultural credit conditions.

Farmland values
Overall, the value of "good" agricultural land continued to rise in the third quarter of 2002, but the survey provided evidence of differences among District states (see map and chart below). From July 1 to October 1, the rate of change in Michigan's farmland values moved ahead of the other states with a 4 percent increase (quarter-to-quarter), whereas Illinois, with no change, trailed the rest. Wisconsin experienced reduced upward pressure on farmland values in the past year, as dairy prices recover very slowly from lows not seen since the 1970s. Farmland value gains in Indiana, where crop yields were poor, have also slowed, with a 1 percent increase, on average, in the third quarter. Iowa exhibited steady growth of 2 percent for the quarter, as crop yields were even stronger than expected.

Percent change in dollar value of "good" farmland

Top: July 1, 2002 to October 1, 2002
Bottom: October 1, 2001 to October 1, 2002

	July 1, 2002 to October 1, 2002	October 1, 2001 to October 1, 2002
Illinois	0	+4
Indiana	+1	+5
Iowa	+2	+7
Michigan	+4	+10
Wisconsin	+1	+7
Seventh District	+2	+7



*Insufficient response.

The average year-over-year increase in District farmland values was 7 percent. Michigan, at one end of the range, recorded a 10 percent gain, while Illinois at the other end reported a 4 percent gain. These gains were supported by demand from nonfarm investors, which seems to have increased as other investments have tumbled and as cities continue to expand. Fueled by demand from the nonfarm sector, 27 percent of Seventh District bankers anticipated farmland values to rise, with only 6 percent seeing a fall. Only in Wisconsin was there a higher proportion of respondents that expect farmland values to fall than rise during the next three months. At the other end of the spectrum, 44 percent of the Iowa bankers that responded predicted a rise in farmland values, reflecting the outstanding yields in much of the state.

Credit conditions

In the third quarter of 2002, agricultural banks had more funds available to lend, but there was flat demand for agricultural loans. Over 30 percent of the bankers reported they had more funds available during July, August and September than they had a year earlier. All District states reported improved funds availability, but a larger proportion of bankers in Illinois, Michigan, and Wisconsin noted increased funds availability. The index of fund availability was 124, highest of the year (see table on page 3). At the same time, 24 percent of the bankers reported higher demand for non-real estate loans, while 25 percent reported a decline. Thus, the index of loan demand dropped to 99, the lowest since an index of 91 last year at this time. There was very little increased demand for non-real estate loans in Michigan reported for last quarter, though the proportion of banks reporting decreases was also the lowest in the District.

Despite the continued pressures on farm incomes in most of the District, the respondents indicated that non-real estate farm loan repayment rates had improved from last quarter, but had fallen since last year. About 30 percent of the bankers reported lower rates of loan repayment, while only 6 percent reported higher rates. These numbers increased the index of loan repayment rates to 76. Moreover, there were more renewals and extensions, with 30 percent, on average, of the bankers noting an increase, and only 7 percent noting a decrease. Lenders in Michigan and Wisconsin reported the lowest levels of loan repayments, as well as the highest levels of renewals and extensions. With signs of increased problems in agricultural loans, banks tightened collateral requirements, with 21 percent requiring a higher level of collateral in the past three months. Very few banks reported lower amounts of collateral required for non-real estate loans.

Offsetting the impact of tighter collateral requirements to some extent, banks reported once again that farm loan interest rates had declined. As of October 1, the District average for interest rates on new operating loans had fallen to 7.17 percent, more than 325 basis points lower than the cyclical peak of two years ago. And, at an average of 6.83 percent, interest rates for farm mortgages were down over 235 basis points from the last peak. The spread widened a bit, another indication of heightened uncertainty in the agricultural sector.

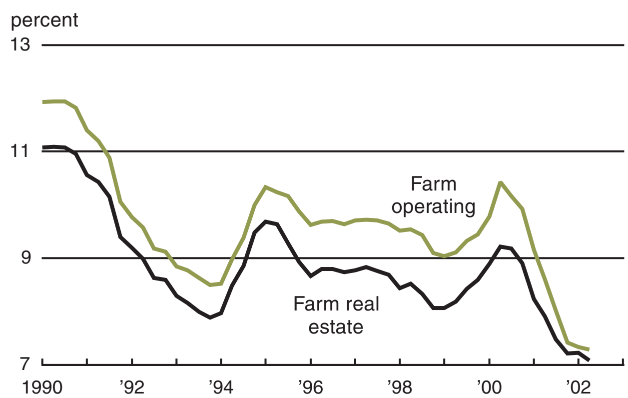
Looking forward

Comparing the fourth quarter of 2002 with the fourth quarter a year ago, 23 percent of the bankers reported that they expect higher non-real estate loan volume, while 23 percent expect lower volume. Respondents look for increases primarily in operating loans (35 percent) and Farm Service Agency (FSA) guaranteed loans (27 percent). Only a fifth foresee higher real estate loan volume. A majority of the respondents indicated that they expected loan volumes would remain the same in the fourth quarter of this year compared with a year ago. However, in Wisconsin over 40 percent anticipate lower volumes for both real estate and non-real estate loans, with a similar percentage anticipating a rise in operating loans. Based on record yields and higher corn and soybean prices than last year, 29 percent of Iowa respondents expect higher farm machinery loan volume, the only state with a sizeable increase.

The increasing reliance on loan guarantees seems to have slowed. Bankers were asked to indicate if they expect to rely more heavily on the USDA's FSA farm loan guarantees during October through December than they did during the same period a year ago.[1] Although 27 percent of the respondents indicated that more loans would have FSA guarantees, 13 percent indicated a reduction in their utilization of the guarantees. Together these numbers represent a slowing in the increased use of FSA guaranteed loans.

The most notable characteristic of the farm real estate market was the 65 percent of bankers that expect higher

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[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)*
1998							
Jan-Mar	134	113	84	68.9	9.52	9.51	8.50
Apr-June	127	102	74	72.7	9.54	9.55	8.52
July-Sept	117	104	60	72.0	9.43	9.41	8.33
Oct-Dec	113	121	57	70.3	9.09	9.07	8.06
1999							
Jan-Mar	120	119	40	69.9	9.03	9.01	8.06
Apr-June	115	107	50	71.7	9.11	9.08	8.18
July-Sept	109	94	63	72.7	9.32	9.28	8.42
Oct-Dec	107	104	72	72.7	9.44	9.41	8.59
2000							
Jan-Mar	121	95	77	72.9	9.78	9.72	8.89
Apr-June	109	76	72	75.5	10.43	10.14	9.21
July-Sept	106	82	77	76.9	10.17	10.14	9.18
Oct-Dec.	105	92	81	74.9	9.92	9.90	8.90
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	75.8	7.17	7.23	6.83

[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.

demand from nonfarm investors for the purchase of agricultural land in their areas over the next six months compared to a year ago. Some bankers speculated that investors pulled out of the stock market to invest in farmland. Respondents see the volume of farmland transfers increasing as well.

Only in Iowa and Illinois (to a lesser extent) did bankers anticipate greater interest by farmers in the purchase of agricultural land. A majority of Wisconsin bankers foresee a retreat in interest in land by farmers, especially as they expect an increase in forced sales or liquidation of farm assets among financially stressed farmers. In fact, across the District bankers foresee some increase in forced sales and liquidations over the next six months compared with last year. Financially stressed operations not only face low prices for many agricultural products, but also must deal with disruptions due to the implementation of the Farm Security and Rural Investment Act of 2002 and uncertainty concerning the passage of emergency federal farm aid. Even though farmland values continued to rise this quarter, and most likely for the near future, there seems to be a spreading unease about the future of agriculture in much of the District.

David B. Oppedahl, *Associate economist*

[1]FSA guarantees apply to ownership and operating loans to farmers who do not meet the standards of conventional lenders. Guarantees may apply up to 90 percent of the loan principal, and lenders may resell the guaranteed portion in a secondary market.

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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	95	–4.0	1	2
Crops (*index, 1990-92=100*)	October	101	–8.2	15	11
Corn (*$ per bu.*)	October	2.36	–4.5	28	36
Hay (*$ per ton*)	October	94.50	–0.1	–4	11
Soybeans (*$ per bu.*)	October	5.16	–4.3	26	16
Wheat (*$ per bu.*)	October	4.41	4.8	54	56
Livestock and products (*index, 1990-92=100*)	October	87	1.2	–16	–10
Barrow and gilts (*$ per cwt.*)	October	32.60	19.9	–20	–22
Steers and heifers (*$ per cwt.*)	October	67.80	–0.3	–3	–4
Milk (*$ per cwt.*)	October	11.9	2.6	–24	–5
Eggs (*¢ per doz.*)	October	54.0	–6.7	–10	–19
Consumer prices (*index, 1982-84=100*)	October	181	0.2	2	4
Food	October	177	0.1	1	4
Production or stocks					
Corn stocks (*mil. bu.*)	September 1	1,599	N.A.	–16	–7
Soybean stocks (*mil. bu.*)	September 1	208	N.A.	–16	–28
Wheat stocks (*mil. bu.*)	September 1	1,740	N.A.	–19	–26
Beef production (*bil. lb.*)	September	2.20	–10.9	4	–3
Pork Production (*bil. lb.*)	September	1.64	0.1	8	5
Milk production* (*bil. lb.*)	October	12.0	3.1	2	2
Receipts from farm marketings (*mil. dol.*)	July	16,269	19.5	–4	1
Crops**	July	7,862	22.0	7	13
Livestock	July	8,407	17.2	–12	–8
Government payments	July	N.A.	N.A.	N.A.	N.A.
Agricultural exports (*mil. dol.*)	September	3,946	–4.2	1	–3
Corn (*mil. bu.*)	August	159	–4.8	–30	–15
Soybeans (*mil. bu.*)	September	31	–17.0	–2	–40
Wheat (*mil. bu.*)	August	94	17.0	2	–13
Farm machinery (*units*)					
Tractors, over 40 HP	October	7,562	59.6	1	0
40 to 100 HP	October	5,157	33.2	5	–1
100 HP or more	October	2,405	177.4	–7	4
Combines	October	779	25.0	–5	–7

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