

Statement of  
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Assistant Vice President  
Federal Reserve Bank of Kansas City  
Before the  
House Committee on Agriculture  
Subcommittee on Livestock, Rural Development, and Credit

June 25, 2014

Thank you Mr. Chairman and members of the subcommittee. My name is Nathan Kauffman, and I am assistant vice president and economist at the Federal Reserve Bank of Kansas City, a regional Reserve Bank that has long devoted significant attention to U.S. agriculture. In my role, I lead several efforts to track the agricultural and rural economy, including a regional agricultural credit survey and the Federal Reserve System's Agricultural Finance Databook, a national survey of agricultural lending activity at commercial banks. I am pleased to share with you the following information on the current state of agricultural credit markets. Before I begin, let me emphasize that my statement represents my view only and is not necessarily that of the Federal Reserve System or any of its representatives.

### **Agricultural Finance and Credit Conditions: 2010 to 2013**

The U.S. agricultural economy has been very strong since 2009. According to the U.S. Department of Agriculture (USDA), average real net farm income from 2010 through 2013, annually, was about 46 percent higher than the average of the previous 10 years. Crop prices surged and cropland values increased dramatically during that time, rising by more than 20 percent annually in key crop-producing states for several consecutive years, which strengthened overall farm sector balance sheets. The crop sector was a primary driver of these near-record farm incomes, while the livestock sector experienced multiple years of poor profits or losses due to elevated feed costs.

Several key measures of agricultural credit conditions monitored by the Kansas City Fed also evolved positively from 2009 to 2013. According to Federal Reserve surveys of agricultural banks, repayment rates for agricultural production loans in the Kansas City, Chicago and Minneapolis districts all improved considerably alongside rising farm income, and profitability at agricultural banks strengthened significantly. During this time, however, bankers commented that agricultural loan demand had fallen, despite declining interest rates, as farmers used more cash to pay for farm-related expenses.

Although the overall financial position of the farm sector had improved, some agricultural producers were more at risk for financial stress than others. Our banker contacts consistently voiced concerns about the viability of some livestock operations facing steep losses, as well as young and beginning farmers with significantly less equity in their operations.

## **Current Agricultural Finance and Credit Conditions**

Since last fall's crop harvest, sharp changes in agricultural commodity prices have led to corresponding changes in the outlook for the farm sector and agricultural finance. Current corn prices are about 40 percent less than last year. Conversely, average fed cattle prices are approximately 25 percent higher than a year ago and, overall, higher livestock prices and lower feed costs have contributed to a rebound in livestock sector profitability.

Lower crop prices and persistently high input costs have reduced profit margins for U.S. crop producers and have affected recent trends in agricultural lending. Toward the end of 2013, declining profit margins reduced farm cash flow, and as a result, demand for operating and other agricultural loans began to rise and lending activity jumped considerably in the first quarter of 2014. The Federal Reserve's Agricultural Finance Databook, included with my written testimony, shows that the volume of new, short-term farm loan originations increased by 28 percent from the previous year in the first quarter. Total farm debt at commercial banks increased by 9.1 percent from a year earlier, and non-real estate farm debt rose by 9.9 percent, the biggest year-over-year increase since 2001. Delinquency rates on agricultural loans, however, have remained historically low and bankers have continued to report that ample funds are available for agricultural borrowers amid a relatively competitive environment for high-quality agricultural loans.

Looking ahead, the level of working capital and liquidity in the farm sector will be crucial components of the financial health and credit conditions surrounding U.S. farm operations. If profit margins remain under pressure in the crop sector and debt continues to rise, the ability of crop producers to withstand an increase in financial stress may be a concern, even as the outlook for the livestock sector has improved. Farmers with lower levels of equity, including young and beginning farmers, may be most vulnerable to financial stress, particularly if cropland values fall and farm income declines from its historically high levels, as projected by USDA and Federal Reserve surveys. Despite these concerns, commercial banks have continued to recognize the long-term potential for U.S. agriculture and have financed the sector accordingly, albeit more cautiously in some areas.

This concludes my formal remarks and I would be happy to answer any questions you may have. Thank you.

## Agricultural Finance Databook

### “Operating Loans Drive Recent Increases in Farm Lending”

By Nathan Kauffman and Maria Akers

April 2014

Farm loan volumes at commercial banks rose dramatically in the first quarter of 2014, driven by increased demand for short-term production loans. According to a national survey of commercial banks from the first full week of February, agricultural producers borrowed larger amounts compared with last year to cover current operating expenses. Lower crop prices reduced cash flow for farmers selling the remainder of last year’s crop and overall crop input costs remained high despite a moderate decline in fertilizer prices. Feeder livestock loan volumes also rose as low inventories pushed feeder cattle and hog prices higher. In contrast, farm capital spending slowed further, lessening the need for intermediate-term farm machinery and equipment financing.

Small and midsize banks added loans faster than their larger competitors under differing terms. Non-real estate farm loan volumes increased nearly 30 percent from last year at small and midsize banks compared with a 20-percent rise at large banks. Commercial banks competed for larger average loan amounts by extending loan maturities and lowering interest rates. The majority of loans at large banks featured a floating interest rate, while customers of small and midsize banks locked in more fixed-rate loans compared with last year.

Loan quality at agricultural banks improved during 2013 and contributed to solid profits. Following steady improvement the past three years, the return on assets at agricultural banks in the fourth quarter held at a high level and annual net income distributions strengthened. Despite a drop in crop prices at harvest, producers still paid down debt, reducing delinquency rates and net charge-offs for both farm real estate and non-real estate loans.

After several years of exceptionally strong price appreciation, farmland values rose at a much slower pace in the fourth quarter. With lower crop prices expected to persist in 2014, most bankers expected farmland values would stabilize while some expected modest declines.

## **Section A**

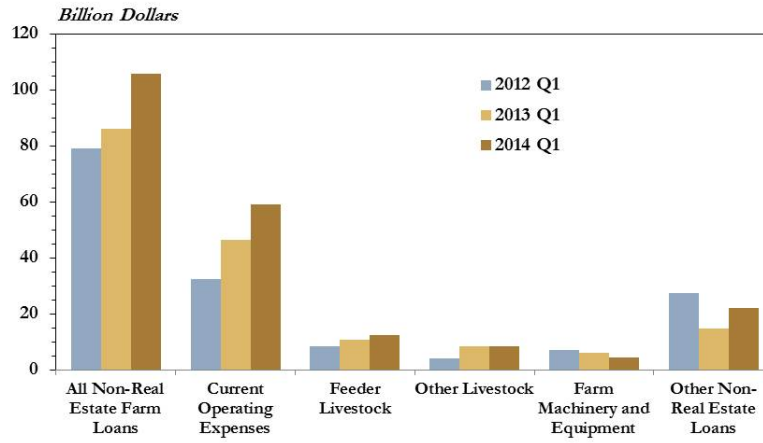
### *First Quarter National Farm Loan Data*

Farm borrowing ramped up in the first quarter as farmers prepared for spring planting. Operating loan volumes reached a record high, exceeding year-ago levels by 28 percent (Chart 1). Crop prices at the beginning of 2014 had fallen 40 percent from the previous year, lowering cash receipts for producers still marketing fall crops. In addition, while prices fell for some crop inputs, such as fertilizer, others, such as seed and fuel, were expected to hold at high levels (Chart 2). Reduced cash flow coupled with elevated crop production costs contributed to the upswing in operating loan volumes. The volume of feeder livestock loans also rose as low cow inventories kept feeder cattle prices elevated and hog prices jumped as an ongoing swine virus continued to limit hog supplies.

Larger operating loans contributed to loan portfolio growth, particularly at small and midsize banks. In the first quarter, non-real estate lending at small and midsize banks rose 28 percent, exceeding the 20-percent rise at large banks (Chart 3). In a competitive lending environment, average effective interest rates continued to edge down and average loan maturities lengthened regardless of bank size. However, at large banks twice as many loans were made with floating interest rates compared with small and midsize banks where fixed-interest rate loans were more prevalent.

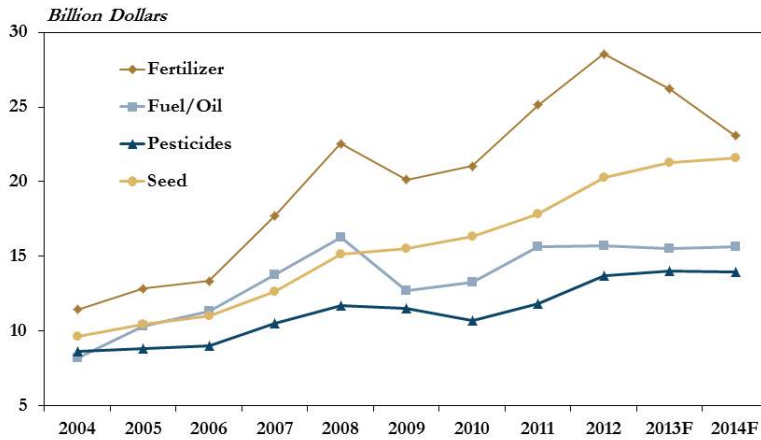
Despite an overall increase in loan volumes, the volume of farm machinery and equipment loans fell by almost a third compared with the previous year, marking the fifth straight quarter of decline. Capital spending may have declined because operators recently upgraded equipment in high income years when tax depreciation rules were more favorable. Additionally, the prospect of lower farm income in 2014 may have shifted financing from intermediate-term equipment loans to short-term operating needs.

**Chart 1: Non-Real Estate Farm Loan Volumes by Purpose**



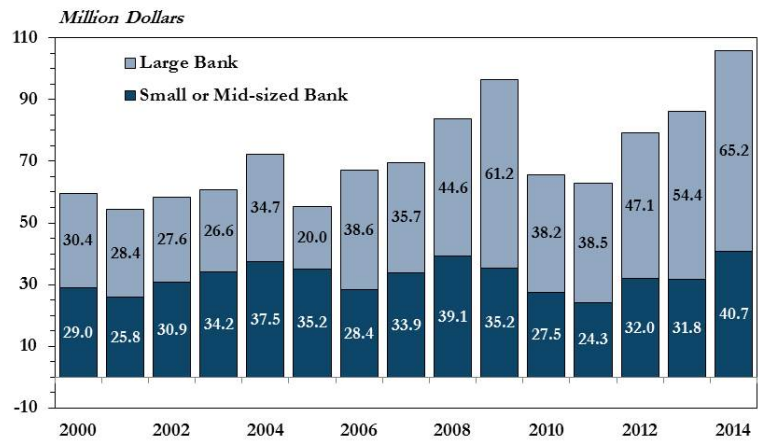
Source: Agricultural Finance Databook, Table A.3

**Chart 2: Principal Crop Input Costs**



Source: USDA, Economic Research Service, Farm Income and Wealth Statistics  
 Note: Data for 2013 and 2014 are forecasts.

**Chart 3: Non-real Estate Loan Volumes by Bank Size**  
(First Quarter)



Source: Agricultural Finance Databook, Table A.3

## Section B

### *Fourth Quarter Call Report Data*

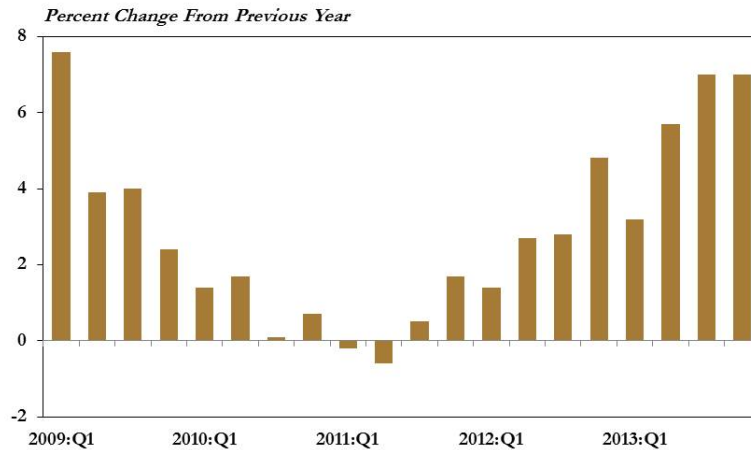
Commercial bank call report data showed that agricultural loan volumes in the fourth quarter exceeded year-ago levels. Total farm debt outstanding as of December 31, 2013, rose 7 percent year-over-year, outpacing the 5-percent gain at the end of 2012 (Chart 4). The volume of loans secured by farmland rose 7.3 percent, followed closely by a 6.6-percent increase in production loans. A drop in crop prices at harvest tightened margins and may have contributed to the rise in production loan volumes at year-end.

Commercial banks reported improved loan performance in the fourth quarter. Delinquency rates on farm real estate loans continued to trend down at both large and small banks. In addition, delinquency rates on non-real estate farm loans dipped below 2 percent at the 100 largest commercial banks for the first time since 2008 (Chart 5). Furthermore, the percentage of farm loans 30 to 90 days past due was smaller than last year, suggesting delinquency rates could fall further. The volume of loans charged off against reserves at agricultural banks fell by almost half compared with the fourth quarter of 2012.

Profitability at agricultural banks remained strong at the close of the year. The return on assets at agricultural banks stabilized at the 10-year average and exceeded returns at other small

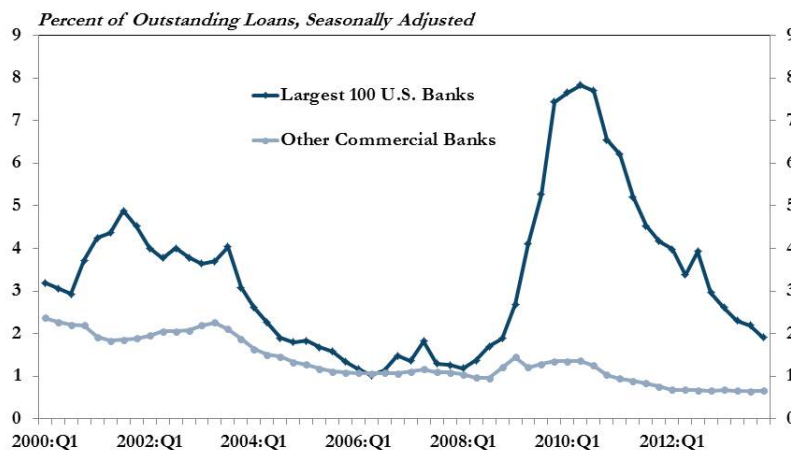
banks by more than one-third (Chart 6). Net income distributions as a share of average equity improved and there were no agricultural bank failures in 2013. With more lending activity, average capital ratios dipped slightly at both agricultural and other small banks in the fourth quarter and average loan-to-deposit ratios were higher than a year ago.

**Chart 4: Farm Debt Outstanding at Commercial Banks**



Source: Agricultural Finance Databook, Table B.1

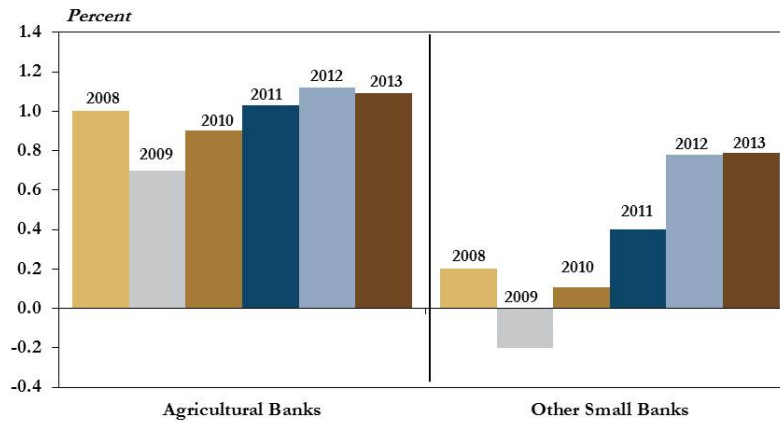
**Chart 5: Delinquency Rates on Non-Real Estate Farm Loans**



Source: Federal Reserve Board of Governors



**Chart 6: Rate of Return on Assets (Fourth Quarter)**



Source: Agricultural Finance Databook, Table B.7

## **Section C**

### *Fourth Quarter Regional Agricultural Data*

Demand for farm operating loans rose sharply in many major grain producing areas in the fourth quarter while farm capital spending waned. The steep drop in crop prices at harvest lowered earlier expectations for 2013 farm income, particularly in the Kansas City Federal Reserve District where drought affected crop yields. Low crop prices also prompted some producers to store grain inventories rather than sell in case prices rebounded later. Reduced cash flow increased demand for operating loans, particularly across the Corn Belt and northern Plains in the Chicago, Kansas City and Minneapolis Districts. Crop receipts were also down in the Dallas District, but bankers indicated strong cattle prices and revenue from oil and gas leases supported overall farm income levels. Conversely, bankers in the St. Louis District reported farm income strengthened compared with the previous year and loan demand weakened. In a reversal of recent trends in which farm capital spending spiked at year-end, contacts in the Chicago, Kansas City, Minneapolis and St. Louis Districts noted a drop in capital investment in the fourth quarter of 2013.

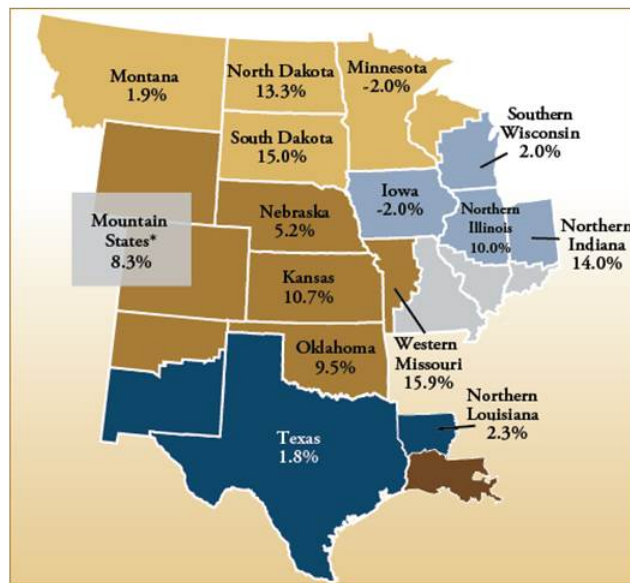
Farm income levels influenced farm credit conditions in the fourth quarter. Loan repayment rates in the Chicago, Kansas City and Minneapolis Districts eased from strong positions earlier

in the year. Bankers in these Districts also reported a modest rise in the number of loan renewals and extensions in the fourth quarter and slightly tighter collateral requirements. However, the Dallas and St. Louis Districts reported stronger loan repayment rates and fewer loan renewals and extensions. Despite minor deterioration in credit conditions in some areas, interest rates on farm operating loans were steady to lower in all Districts except Kansas City where they edged higher. Interest rates on farm real estate loans fell further in the Dallas, Minneapolis, Richmond and St. Louis Districts, held steady in the Kansas City District and rose slightly in the Chicago District.

Agricultural bankers indicated farmland value gains slowed dramatically in the fourth quarter despite less farmland for sale compared with last year. In particular, bankers in Corn Belt states reported year-over-year increases in nonirrigated cropland values moderated from previous highs (Map). There was even a slight pullback in cropland values in parts of Minnesota and Iowa. Energy activity continued to support farmland value gains in the Dakotas, but a majority of bankers felt that lower farm income expectations for 2014 would limit further farmland value gains in major crop producing areas.

### Map: Value of Non-Irrigated Cropland (Fourth Quarter, 2013)

*Percent Change From Previous Year*



\*Mountain States include Wyoming, Colorado and northern New Mexico, which are grouped because of limited survey responses from each state.  
Sources: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City and Dallas)

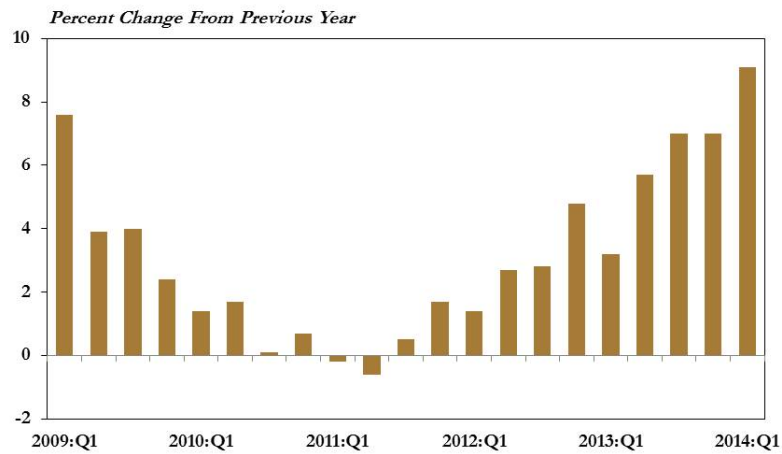
## Addendum

### Agricultural Finance Databook

*Previous charts updated through First Quarter 2014*

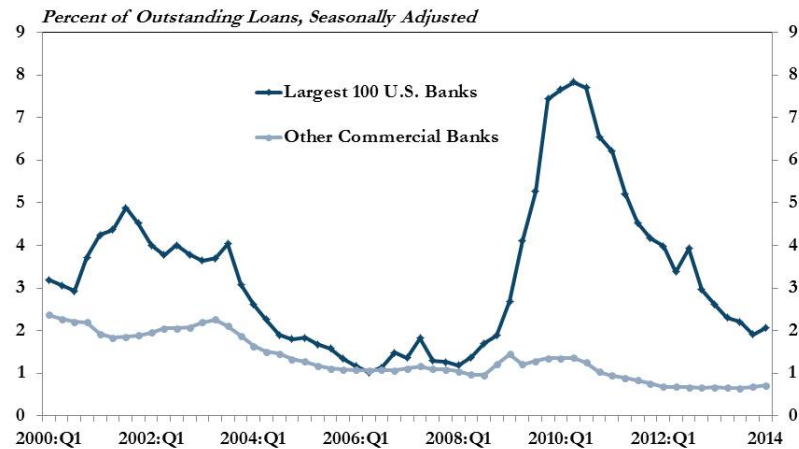
## Section B

### Chart 4: Farm Debt Outstanding at Commercial Banks



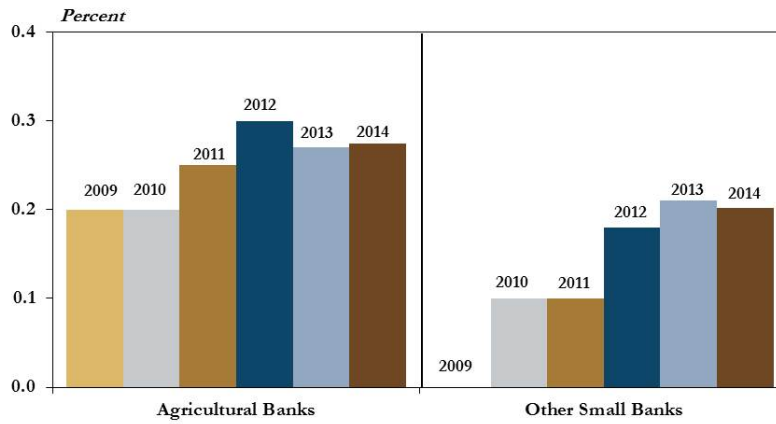
Source: Agricultural Finance Databook, Table B.1

### Chart 5: Delinquency Rates on Non-Real Estate Farm Loans



Source: Federal Reserve Board of Governors

**Chart 6: Rate of Return on Assets (First Quarter)**

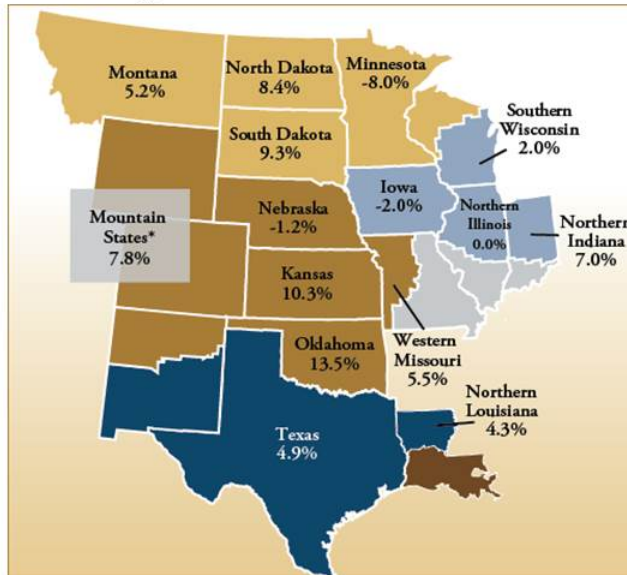


Source: Agricultural Finance Databook, Table B.7

**Section C**

**Map: Value of Non-Irrigated Cropland (First Quarter, 2014)**

*Percent Change From Previous Year*



\*Mountain States include Wyoming, Colorado and northern New Mexico, which are grouped because of limited survey responses from each state.  
Sources: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City and Dallas)