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| Agricultural Lender Survey |
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**Results:  
Spring Survey 2016**

# Survey Summary and Highlights

For the Spring 2016 edition of the agricultural lender survey, lenders from across the nation reported their expectation for interest rates, spread over cost of funds, farm dollar volume, non-performing loans, and agricultural land values. The major theme from lender responses is that the agricultural economy is slowing and that the expectations for relief to farmers is a few years away. This sentiment is summed up by the comments of one respondent:

“We are in the early stages of a major correction in the agricultural economy.  Given the accumulation of corn & soybean inventories, this could be a prolonged and painful process.  Eventually an equilibrium of costs and revenues will be reached and the agricultural economy will stabilize. The producers that made conservative decisions will weather the storm, others will need to make major adjustments or fail.”

Many lenders stated that low commodity prices and stubbornly high input prices continue to put pressure on cash flows. Below is a summary of the highlights from the Spring 2016 survey.

* Short-term expectations are for land values continues to decrease.
* Lenders indicate a reversal in the downward trend for spread over cost of funds. This is the first increase in spread over cost of funds reported since the inception of this survey in Spring 2013, and may be indications of an increased risk premium needed for agricultural lending.
* From Fall 2015 to Spring 2016, lenders noted that the number of non-performing loans rose for total farm loans.
* Lenders expect non-performing loans to continue its rise, particularly for the corn and soybeans, wheat, and beef sub-sectors.
* Demand for farm operating loans remains high as liquidity and cash flow are problematic for many producers.
* Respondents reported cash rental rates remain elevated and have been slow to adjust with the decline in commodity prices.

The Department of Agricultural Economics at Kansas State University conducts a semi-annual survey of Agricultural Lenders to gage the recent, short term and long term future assessment of the credit situation for production agriculture.  The results provide a measure of the health of the sector in a forward looking manner.

Each institution surveyed provided their sentiment on the current and expected state for: (1) farm loan interest rates; (2) spread over cost of funds; (3) farm loan volumes; (4) non-performing loan volumes; and (5) agricultural land values. Within each of these key areas, different loan types were assessed (farm real-estate, intermediate and operating loans) as well as the different agricultural sectors (corn and soybeans, wheat, beef, dairy, etc.).

The survey responses are summarized using a diffusion index. This index is calculated by taking the percentage of those indicating increase minus the percentage of those indicating decrease plus 100. Therefore, an index above (below) 100 indicates respondents expect or experienced an increase (decrease) in the measure of interest. For example, Figure 2 illustrates that the index for the Spring 2016 expected long-term farm real estate loan interest rates equals 197. This number can be described as 97% more respondents felt farm real estate loan interest rates will go up in the long run than those who felt interest rates would go down.

Figure 1, Demographics of Survey Respondents

Figure 1 shows the demographics of the Spring 2016 survey respondents by primary service territory. The five territories are: Midwest, West, Atlantic, South and Plains. Table 1 has a list of the states in each region. Fifty-four percent of survey respondents came from the Plains region while 32%, 0%, 7% and 7% came from the Midwest, West, Atlantic, and South regions, respectively. Nine percent of respondents indicated their respective lending institution was national in scope.

Lenders expect interest rates to rise. Figure 2 shows the continued expectation of higher interest rates in the future. Over the past three months, 45% of respondents indicated an increase in interest rates for farm real estate loans. This rise was partially caused by the increase of the Fed Funds Rate by the Federal Reserve in December, 2015. Staying with past trends, no respondents expect interest rates to decrease in the short-term or long-term. Furthermore, this survey was the third consecutive survey where no respondent expects a decrease in interest rates in the short-term or long-term (Table 2).

Figure 2, Loan Interest Rates – Diffusion Index of Survey Respondents

The spread over cost of funds is the difference between the loan interest rates charged by the lending institution and the interest rate paid by the financial institution for the funds that they deploy in their business. The reason for obtaining information for both loan interest rates and spread over cost of funds is to gauge competition in the agricultural lending market. A decrease in the spread over cost of funds suggests competition for agricultural loans among lending institutions may be increasing. Also, this information may reflect an increase in the premium for agricultural lending.

This survey marks the first time lenders have indicated an increase in the spread over cost of funds over the past three months. Figure 3 shows that survey respondents expect this trend to continue for both the short-term and long-term for all loan categories. However, despite more respondents reporting an increase in spread over cost of funds, the majority of lenders reported no change in the spread over cost of funds. Lender expectations for the future increases still remain divided with 50% of lenders expecting no long-term change and 50% of lenders expecting an increase.

Figure 3, Spread Over Cost of Funds – Diffusion Index of Survey Respondents

While farm loan volumes rose significantly over the past three months, the increase farm real estate loan volumes are expected to slow. Figure 4 shows the responses for the aggregate amount of agricultural lending. Lenders expect total farm loan volumes to continue to increase, but farm real estate loan volumes are not expected to rise by as many respondents as in previous surveys. The current high demand for funds is a reflection of the deteriorating liquidity position of farmers and is more pronounced for operating credit.

The sentiment for farm real estate loans continues on a downward trend in the long term that started with the peak in lender expectation in Spring 2014. This is partly due to the decreasing demand for farmland. The expectation for operating loan volume remains high for the short-term and long-term due to lower cash farm receipts, though it has decreased slightly in the short-term from the Fall 2015 survey likely due to expectations of lower operating expenses. One respondent noted:

“I am seeing significant decrease in capital purchases and family living.  I expect other operating expenses to follow.”

Figure 4, Farm Loan Volume – Diffusion Index of Survey Respondents

Lenders expect non-performing loans to increase. Figure 5 shows the results for non-performing loans analyzed by loan type. 43% of respondents indicated an increase in non-performing loans. It is concerning that this increase represents a 31% percentage point increase from Fall 2015 (Table 2). Agricultural lenders expect that non-performing loans will increase during the next year, 77% in the spring of 2016 compared to 53% in the fall of 2015. Over the next 2 to 5 years, the sentiment is that non-performing loans will increase, but that sentiment has lessened slightly over the last two surveys.

With that said, not all lending institutions are feeling the pressure. Rising non-performing loans are not necessarily universally felt by all lenders. One respondent noted:

“We only have one farm loan that is classified. If commodity prices remain low, could be more in the future.”

Figure 5, Non-Performing Loans, By Loan Type – Diffusion Index of Survey Respondents

Non-performing loans are rising across all crop production sectors. Figure 6 shows the non-performing loans by crop industry sector. Respondents continued to indicate an increase in expectations for non-performing loans for corn and soybeans and wheat.

“With these crop prices expect a significant gut check by the producers.”

Fruits and vegetables also experienced an increase in the long-term expectation for non-performing loans. This is partly due to expanded orchard plantings in reaction to recent, sizeable profits.

“The last seven or so years have been very profitable for tree fruit which has spurred orchard development. With new orchard acres and more productive plantings coming on line it is expected that tree fruit will be coming under pressure for next half dozen years.”

Figure 6, Non-Performing Loans, By Crop Industry Sector – Diffusion Index of Survey Respondents

Similar to the crop sector, non-performing loans for livestock producers are expected to rise. Figure 7 shows the non-performing loans for various livestock sectors. This was the first survey that respondents indicated an increase in non-performing loans for the beef sector during the past three months. Recent declines in livestock prices are beginning to impact loan performance.

Expecting tighter margins for cow/calf ahead as we are into herd building, expect feed yard margins to improve in last quarter of 2016.”

Figure 7, Non-Performing Loans, By Livestock Industry Sector – Diffusion Index of Survey Respondents

During the spring 2016 survey window, 48% of agricultural lenders indicate that land values decreased and 45% indicate that they remained the same, and 6% indicate they increased during the previous three months. The spring 2015 results indicated that 35% indicated decreases, 57% indicated no change, and 8% indicated increasing land values for the previous three months. The expectation of land value changes in the next year became markedly more negative from the fall of 2015 to the spring of 2016 with the index falling from 32 to 16. Currently 84% of lenders expect land values to fall over the next year and 16% expect they will remain the same. For the longer term, the sentiment has not changed much over the last four surveys; roughly 65% expect decreases, 25% expect no change, and the remainder expect land price increases. The overall sentiment by agricultural lenders turned more pessimistic from the fall of 2015 to the spring of 2016. One respondent stated:

“Cropland values have declined 15-25% depending on quality.  Pasture values have stayed fairly constant, although the lack of sales might indicate that they are priced too high given the market.”

Figure 8 Land Values – Diffusion Index of Survey Respondents

Table 1, States in Each Region

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| Atlantic | CT, DE, KY, ME, MD, MA, NH, NJ, NY, NC, PA, RI, TN, VA, VT, WV |
| South | AL, AR, FL, GA, LA, MS, SC |
| Midwest | IA, IL, IN, MI, MN, MO, OH, WI |
| Plains | KS, NE, ND, OK, SD, TX |
| West | AZ, CA, CO, ID, MT, NM, NV, OR, UT, WA, WY |

Table 2, Respondent Responses



Table 2 Continued, Respondent Responses



Table 2 Continued, Respondent Responses

