Credit Conditions Shaped by Risk-Return Trade-off

Transitions in Agriculture: Implications for Research, Data Development and Policy Analysis
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The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
“Cost of capital items (land) preclude young farmers from borrowing unless they can get FSA low rate financing.”

“With land prices this high young farmers can't buy any land without support of someone who has financial strength.”

“Nearly impossible to compete with existing established farmers. Without family, equipment, land and backing it is very difficult to be a ‘young, beginning’ farmer.”

“Unless a young or beginning farmer is part of a family operation or has a fairy godmother the barriers are almost insurmountable even in this low interest rate environment.”
Agricultural Credit Survey

Kansas City District
Nebraska, Kansas, Oklahoma, Wyoming, Colorado, Missouri, New Mexico

• Survey of ~250 Commercial Bankers

• Farmland values, cash rents, farm incomes

• Credit conditions: interest rates, collateral requirements, loan demand, funds availability, etc.
Agricultural credit conditions at commercial banks have cycled.

Source: Agricultural Finance Databook

*Commercial bankers responded by indicating whether conditions during a given quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percentage of bankers who responded “lower” from the percentage who responded “higher” and adding 100.
Land values are still surging.

Source: Federal Reserve Bank of Kansas City, Survey of Agricultural Credit Conditions
Young farmers have less equity, with a higher non-real estate debt burden.

Farm incomes are projected to decline sharply in 2014.

Billion Dollars (Constant 2012 Dollars)

Source: USDA, FAPRI
Grain markets have become more volatile.

* Calculated as 10-day historical volatility using standard deviation of daily corn prices, then annualized and expressed as a quarterly average.
Credit markets are responding to risk.

* Bankers responded by indicating whether conditions in the fourth quarter of 2012 are typically higher than, lower than, or the same for young and beginning farmers relative to other farmers. The index numbers are computed by subtracting the percentage of bankers who responded “lower” from the percentage who responded “higher” and adding 100.
Circumstances are not entirely unique to agriculture.

  - 37% of loans were denied
  - 13% approved for full amount
  - Larger, more experienced firms were more successful in obtaining credit.
  - Insufficient collateral the #2 reason for refusal (28%).

- **National Small Business Association Survey (NSBA 2012)**
  - 25% denied based on collateral
  - 31% rely on lending from friends and family
Conclusions

- Agriculture has high capital costs, constraining entry.
- Higher collateral is a rational response to greater risk.

Questions
- Are risks being properly measured?
- Is the land ownership model tenable?
- What makes agriculture different?
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