Farm Finances Remain Healthy

The overall financial health of farmers and their lenders remains solid in early 2000, despite low prices for major farm commodities over the last couple of years. Large Federal payments to farmers have mitigated the negative effect of lower prices on farm financial conditions and have played a key role in stabilizing farm income, particularly for farms producing food and feed grains, oil crops, and cotton. For 3 years beginning in 1998, farmers are expected to receive $49 billion in direct government payments, up from $22 billion in 1995-97. This includes $14 billion of emergency payments from legislation enacted in 1998 and 1999.

Government payments, by providing liquidity to farmers, are reducing demand for credit and underpinning farm creditworthiness. Lenders have ample funds to loan and most farmers who applied for credit have been able to obtain credit for the 2000 crop year. However, without additional emergency farm payments this year, farm lenders will be dealing with a farm sector whose net cash income is forecast to decline 11 percent in 2000 (see Farm Income brief on p. 6).

Many farmers, particularly small operators, depend more on off-farm than farm income for total household income. On average, 88 percent of total farm operator household income in 1998 came from off-farm sources. Even for large family farms (total sales $250,000 to $500,000), a substantial portion of total household income in 1998—44 percent—came from off-farm sources. These large family farms had average household income exceeding twice the average for all U.S. households in 1998, with a very large contribution to total income coming from off-farm wages. For the majority of family farms, stability in off-farm income is at least as important to creditworthiness and overall financial health as stability in farm income. The general economy is strong, and prospects for off-farm income remain generally good across the country.

Nevertheless, if low commodity prices persist throughout 2000, cash-flow problems for farm businesses—particularly large ones that depend heavily on farm income—could grow in the absence of continued emergency farm payments. In 2000, farmers are expected to substantially increase the use of their available debt repayment capacity, a measure of the extent to which farmers are using their lines of credit. Farmers are expected to use almost 66 percent of the debt that could be supported by their current incomes. This is up from an estimated 56 percent in 1999, but well below the 1981 peak of 107 percent.

Farm Debt Stable, Interest Rates Up

Farm debt at the end of 2000 is forecast at $173 billion, essentially unchanged from 1999. Uncertainty over how long commodity prices will remain low is depressing demand for farm credit. In addition, an upward trend in farm interest rates makes borrowing for capital expenditures more expensive. After rising briskly during much of the 1990's, farm debt has leveled off since 1998, as farmers have been more conservative with their borrowing.

The national farm balance sheet remains strong. Farm-sector equity is projected to total $900 billion at the end of 2000, up slightly from levels reported the last few years. Farmland currently accounts for roughly 77 percent of farm-sector assets, and a little over half of total farm debt is collateralized by farmland. Consequently, the financial security of farm borrowers and their lenders is affected by changes in farm real estate values.

Nationally, farmland values have increased at an average compound rate of over 4 percent since 1987. This has significantly improved the financial position of many farm businesses, strengthening their ability to borrow and to weather the current period of lower cash receipts from crops.

Since 1991, the total value of farm real estate rose over $200 billion to $831 billion in 1999, although growth has slowed in recent years with sharply lower field crop prices. (Growth in farmland values is expected to be minimal in 2000.) Farmland values have been aided by record government payments and by other factors, such as the nonfarm or urban demand for farm real estate. ERS estimates that the urban influence on farmland values accounts for 25 percent of the market value of all U.S. farmland.

Interest rates on farm loans "bottomed out" during the first quarter of 1999 and then trended higher into early 2000. Increases are largely the result of five 25-basis-point increases in the Federal funds target rate instituted by the Federal Reserve since June 1999 (1 basis point is 0.01 percentage

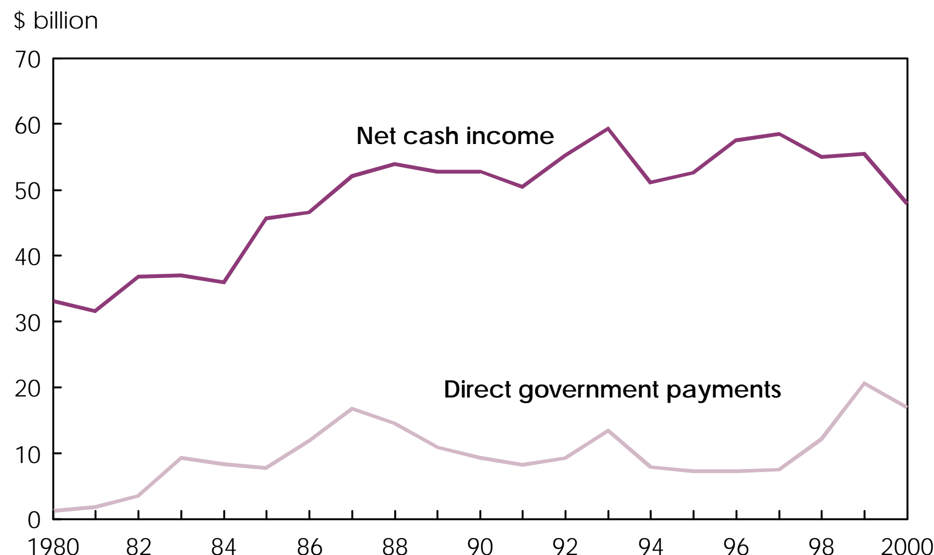
point). Further increases in the Federal funds rate are likely in 2000 as the Federal Reserve tries to rein in rapid economic growth and thereby avert inflation. Because commercial lending rates, such as farm loan rates, are tied to the Federal funds rate, further increases in farm loan rates are likely in 2000 (see the following article on interest rate prospects).

A rise in interest rates on new farm loans could put additional financial burden on highly leveraged farms, particularly those that have borrowed heavily for recent expansion in production. On the other hand, some farm households benefit from rising interest rates because their interest income from investments rises.

Farm debt tends to be concentrated among a relatively small number of farms, with larger farms more dependent than smaller farms on borrowed capital and on farm income to repay loans. Roughly half of all farms report having no debt at yearend.

Despite expected higher farm interest rates for 2000, total interest expenses paid by the farm sector are expected to rise only modestly in 2000 as total credit use falls somewhat and there is the usual delay in repricing (from refinancing) much of farm debt. Some farm debt, particularly farm real estate debt, is financed over longer terms at fixed interest rates. Farmers and their lenders tend to shift from fixed-rate loans to lower cost variable-rate loans when interest rates rise.

Increase in Government Payments Maintained Farm Income in 1999



1999 preliminary; 2000 forecast.
Economic Research Service, USDA

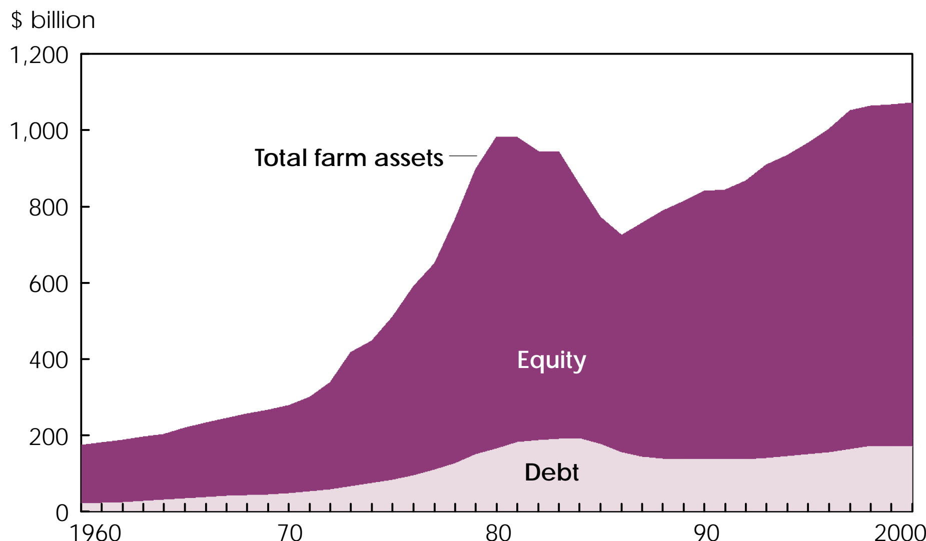
To help farmers cope with cash flow problems in 2000, Congress boosted the authority of the Farm Service Agency (FSA) to make and guarantee farm loans. This authority includes the ability to make farm ownership and operating loans at interest rates of 5 percent and reduce rates on guaranteed loans by 4 percentage points. As the "lender of last resort" for the farm sector, FSA provides or guarantees loans to farmers who cannot otherwise qualify for loans at commercial institutions.

Congress has authorized more than $4 billion in FSA guaranteed loan program lending and $1.7 billion in direct loan program lending for fiscal 2000. In fiscal 1999, FSA made or guaranteed $3.8 billion in farm loans. If all authorized funds were loaned in fiscal 2000, it would be the highest level of USDA farm lending since the farm financial stress of the mid-1980's. As of the end of April, it appears that funding is sufficient to meet program demand.

Farm Lenders Remain Strong

Financial institutions serving agriculture continued to experience improved conditions in 1999, and some additional gains are possible in 2000. The sound position of agricultural lenders reflects the generally healthy state of farmers' finances in the mid-1990's and a strong nonfarm economy. But continued low prices for

Farm-Sector Debt Flattens in 1999 and 2000 While Equity Continues Growing



1999 preliminary; 2000 forecast.
Economic Research Service, USDA

Farm Finance

key agricultural commodities, regional weather and disease problems, and uncertainty over future Federal farm support continue to raise concerns among lenders about the ability of some farmers to repay new or existing loans.

At the end of 1999, *commercial banks* accounted for 40 percent of all farm debt outstanding, making them the leading agricultural lenders. The *Farm Credit System (FCS),* which holds 27 percent of all farm debt, is second to commercial banks. Farmers obtain 22 percent of their credit needs from *merchants, dealers, and individuals* (e.g., through land purchase credit contracts). *FSA* holds about 5 percent (and guarantees another 5 percent) of all farm debt, and its programs target family-sized farms with limited resources. For these farms, FSA is a more important source of credit than its national share of total farm debt implies. A handful of *life insurance companies* supplies about 6 percent of credit to the agriculture sector.

All major institutional lender groups continue to report generally healthy farm loan portfolios. Most lenders report low levels of delinquencies, foreclosures, net loan charge-offs, and loan restructuring. Even FSA reported an improving farm loan portfolio for the 11th consecutive year. These aggregate farm lender indicators are expected to remain favorable barring a sustained increase in farm financial stress. Furthermore, even if financial stress were to increase markedly, there would be a lag before it affected financial institution performance at the national level.

The financial health of commercial banks specializing in agricultural lending (agricultural banks) remained sound going into 2000. Delinquent farm loan volume and charge-offs of agricultural loans did increase modestly during 1999, and bank examiners noted greater carryover debt at farm banks. Nonetheless, agricultural banks reported high average returns on equity and assets, and loan loss provisions were consistent with an optimistic outlook regarding future loan losses. These developments indicate that problems in the farm sector have not seriously affected farm bank loan portfolios. Only one agricultural bank failed in 1999, and only five failed during 1994-99.

WINDOW on the PAST

Excerpts from USDA publications

Mortgage Rates Low

Interest rates on long-term loans are now the lowest they have ever been in the United States. The rate for new loans from the Federal land banks is 4 percent, and the rates of most other lending agencies have shown sharp reductions.

The unusually low farm-mortgage interest rates make it desirable for farmers who have short-term or high interest-rate mortgages to refinance such loans on a long-time basis.

The Farm Outlook for 1937

Contact: Anne B.W. Effland (202) 694-5319
aeffland@ers.usda.gov

Banks continue to have sufficient funds to lend to creditworthy farms. The average loan-to-deposit ratio for agricultural banks was nearly 72 percent as of the first of the year, up from 68 percent a year earlier and 57 percent at the end of 1992. However, in the current financial environment, commercial banks can easily access nondeposit sources of funds. The Gramm-Leach-Bliley Act of 1999, which became law in November 1999, allows farm banks to supplement other sources of loanable funds by providing improved access to a stable source of long-term funds from the Federal Home Loan Bank System. Commercial banks, as well as other lenders, can also use the Federal Agricultural Mortgage Corporation to fund farm and mortgages.

The financial condition of the Farm Credit System remained solid entering 2000. Loan volume was up 3 percent in 1999, and capital continues to grow. Loan portfolio quality is strong, having improved since December 1998. During 1999, the FCS reported net income of over $1.2 billion, down only slightly from 1998. In the last 2 years, higher provisions for loan losses, many in conjunction with problem loans originated by one FCS bank (which were loans to co-ops and not farmers), have reduced reported FCS income.

FSA's direct loan program delinquency rate fell for the 11th consecutive year to 15.6 percent at the end of fiscal 1999. Outstanding direct loan volume also slipped below $9 billion as loan repayments and write-offs exceeded new lending activity. Extensive use of loan-servicing options (e.g., deferred payments) has helped keep FSA delinquencies from rising. However, delinquent guaranteed loan volume rose slightly to 2.4 percent, the highest delinquency rate since fiscal 1985, when the guarantee programs were first emphasized.

Life insurance companies historically have provided mortgage credit to the farm sector and now specialize in supplying large credit needs, often in amounts exceeding $1 million. Life insurance companies that are still active in farm lending report that they have adequate funds for qualified borrowers and that current borrowers continue to meet repayment terms.

While the financial health of agriculture has slipped somewhat over the last couple of years, it remains strong for most farm types and in most regions. Overall, leverage remains at modest levels, and most farmers have been able to repay their loans or work out alternatives with their lenders. By stabilizing farm incomes, government assistance has in turn played an important role thus far in stabilizing farmland and farm credit markets. Major farm lenders have been able to accommodate their agricultural borrowers and in general are in good financial condition. AO

Jerome Stam (202) 694-5365, Steve Koenig (202) 694-5353, Dan Milkove (202) 694-5357, and Jim Ryan (202) 694-5586
jstam@ers.usda.gov
skoenig@ers.usda.gov
dmilkove@ers.usda.gov
jimryan@ers.usda.gov