FALL 2018
AGRICULTURAL LENDER SURVEY RESULTS

FARMER MAC
FINANCING RURAL AMERICA

American Bankers Association

Contents

Key Takeaways

- In general, lender sentiment remained steady between December 2017 and August 2018, exhibited by a similar percentage of respondents reporting farm profitability declines, increases in farm leverage and increases in interest rates.
- Grains, dairy and hogs were the sectors that concerned lenders the most, while lenders reported less concern for the cattle, poultry and vegetable sectors in the first half of 2018.
- Customer financial health is at the center of lender concern at the borrower level — commodity prices, liquidity positions, income levels and financial leverage remain the top four concerns in the first half of 2018. A rising interest rate environment was the fifth-highest-rated concern among lenders.
- Lender attitudes on land values ticked up in 2017 and 2018, with fewer respondents reporting declines in land values compared to December 2016. This trend was consistent across most regions. Many lenders expect the pace of land listed for sale to quicken in the second half of 2018 (50 percent), and more than a third expect the pace of land sales that close to increase as well (40 percent).
- The average agricultural lender expected 51 percent of their customers to be profitable in 2018, unchanged from December 2017.
- Loan deterioration and portfolio credit quality stayed atop lender business concerns in early 2018, but concern over rising interest rates increased significantly.
- Lenders reported a new application average agricultural loan approval rate of 74 percent in the 12 months leading up to August 2018. Existing loan renewals are expected to be approved in late 2018 and early 2019 at a rate of 88 percent, unchanged from December 2017.
- Nearly all survey respondents expected short-term interest rates to continue to rise in the latter half of 2018 (92 percent), and a vast majority of respondents expected long-term interest rates to rise as well (82 percent). Fewer than 1 percent of responses expected rates to fall in the second half of the year.

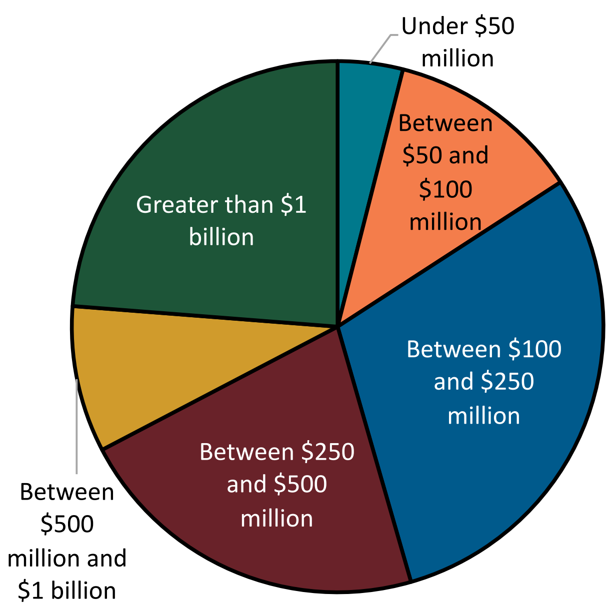
Introduction

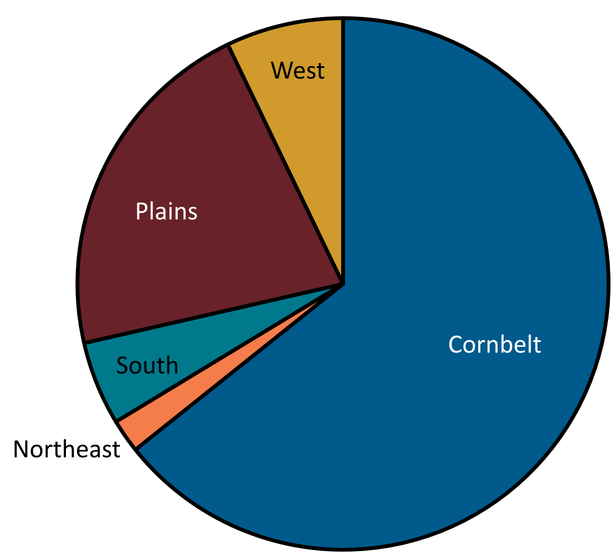
Agricultural lenders can provide a unique outlook on circumstances in the farm economy. Farmers and farm businesses that use short- or long-term financing are routinely required to present financial updates to their loan officers, giving lenders a distinct opportunity to evaluate local farm economy conditions. These insights are particularly valuable during times of transition, when the agriculture sector is cycling through economic troughs and peaks.

In December 2016, the American Bankers Association (ABA) and Farmer Mac collaborated on their first joint survey of agricultural lenders to gauge overall industry sentiment on the farm economy, expectations on land values, prospects for the coming year and issues facing the broader economy. This collaboration has continued every six months since its inception. These joint studies expand upon data collected by Farmer Mac in prior years.

The survey was distributed via email between August 1 and August 31, 2018. Nearly 350 loan officers, managers and executives responded to the questionnaire. Responses represent a range of institutions by size—from less than $50 million in assets to more than $5 billion—and by geography. This analysis breaks down results by general agricultural economic insights and by factors affecting lending institutions. The report concludes with a broader description of the respondent demographics.

Respondent Size and Primary Market Region





Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018

Agricultural Economy

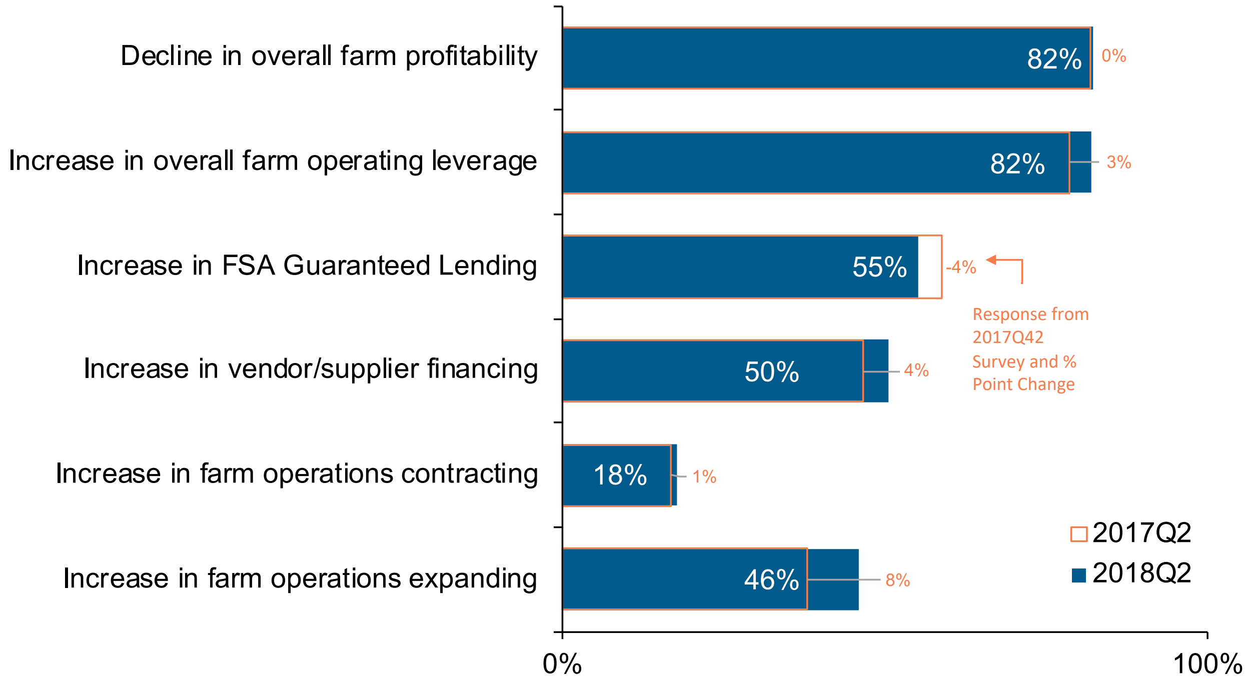
Farm Profitability and Economic Conditions

During the first half of 2018, agricultural lenders' sentiments of the overall agricultural economy remained relatively stable. A very high percentage of respondents reported a decline in farm profitability in the last six months (82 percent). However, that percentage is down more than seven points since the December 2016 ABA-Farmer Mac survey, and is flat compared to results from the June 2017 survey. Most other categories showed only small improvements or no change at all from 2017. For example, the percentage reporting higher levels of operating leverage remained roughly unchanged at 82 percent. Lenders also reported a similar percentage of farms expanding (46 percent, up from 38 percent reported in 2017), and also a similar proportion of farm operations contracting (18 percent, unchanged from the value reported in 2017). A slightly lower proportion of respondents indicated increasing usage of the Farm Service Agency's (FSA) Guaranteed Loan program (55 percent, down from 59 percent reported in 2017). These findings coincide with recent analysis from the United States Department of Agriculture's Economic Research Service (USDA ERS),[1] and the Federal Reserve Bank of Kansas City's Agricultural Credit Survey and Agricultural Finance Databook products[2], in which analysts reported mostly-stable conditions in the agricultural economy for the first half of the year. Looking to the second half of 2018, lenders expect 51 percent of their customers to remain profitable, a slight decline from December 2017 (55 percent).

[1] USDA Economic Research Service. Farm Income and Wealth Outlook. https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/

[2] Federal Reserve Bank of Kansas City. Agricultural Credit Survey and Agricultural Finance Databook. https://www.kansascityfed.org/research/indicatorsdata/agcreditsurvey https://www.kansascityfed.org/research/indicatorsdata/agfinancedatabook

Agricultural Lenders' Observations



Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017/August 2018
Mean response to Q10: During the past 6 months, how have the following conditions changed for your area?

The outlook on farm profitability varies by region. While lenders in all the reporting regions[3] expect poor, persistent economic conditions on the farm, the results were regionalized. The variations are driven by the high percentage of Cornbelt and Plains lending that is concentrated in commodity crops such as corn and soybeans, where market prices remain near cyclical lows. Growers in the West and South regions produce more specialty crops, which are less subject to swings in commodity markets.

At the commodity sector level, dairy products and commodity crops are among the top concerns for lenders. When asked to rate their level of concern on a scale of one (lowest concern) to five (highest concern) for each of the major farm sectors, respondents consistently rank dairy, grains and beef cattle among their top concerns. Approximately 85 percent of all respondents rated the dairy sector as a top concern, compared to 72 percent at the end of 2017. Concern for grain producers remains elevated (78 percent ranked the sector as a top concern compared to 80 percent in 2017). The sector ratings are in line with production and regions, with the Cornbelt and Plains regions registering the highest levels of concerns over the grains and beef cattle sectors. Lenders in the West and Cornbelt reported high levels of concern over the dairy sector, which has seen significantly lower milk prices in 2018 compared to 2017. While concern for dairy showed the most substantial increase (85 percent highly concerned in 2018 compared to 56 percent in 2017), the swine sector also showed degradation (42 percent highly concerned in 2018 compared to 20 percent in 2017).

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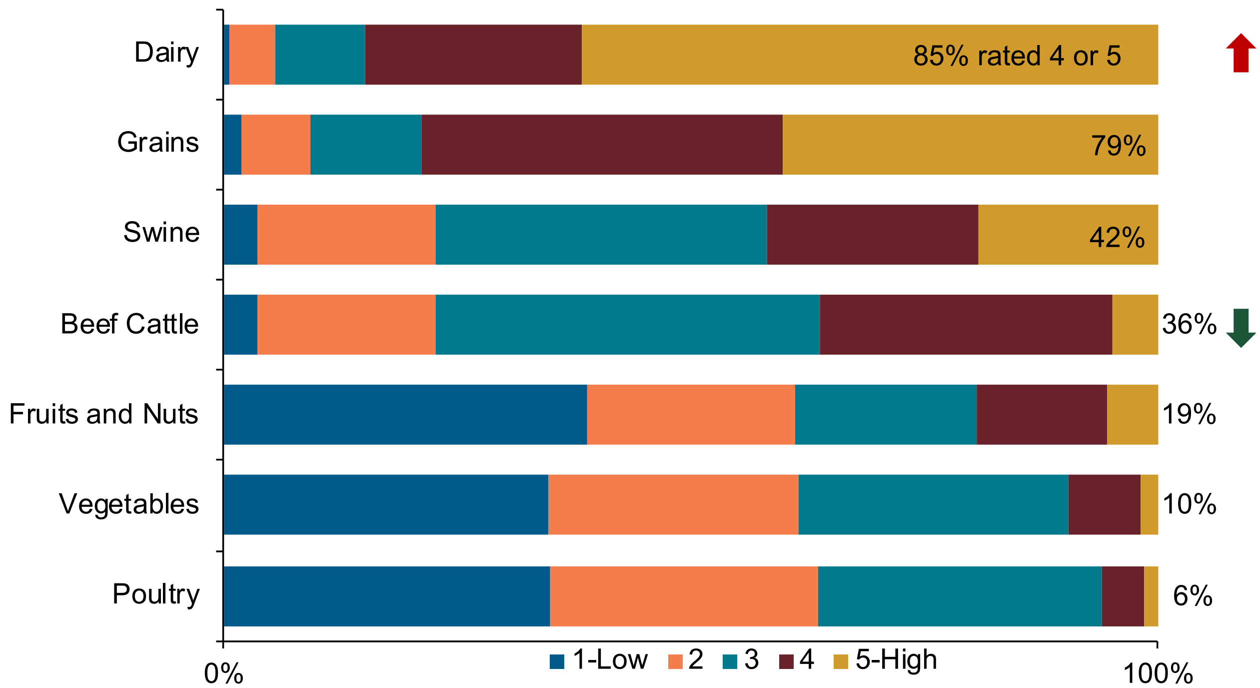
[3] There were not enough valid responses from the Northeast region to make statistically significant, region-specific statements, and thus the Northeast was excluded from region-level analysis. However, these responses were included in the overall response statistics.

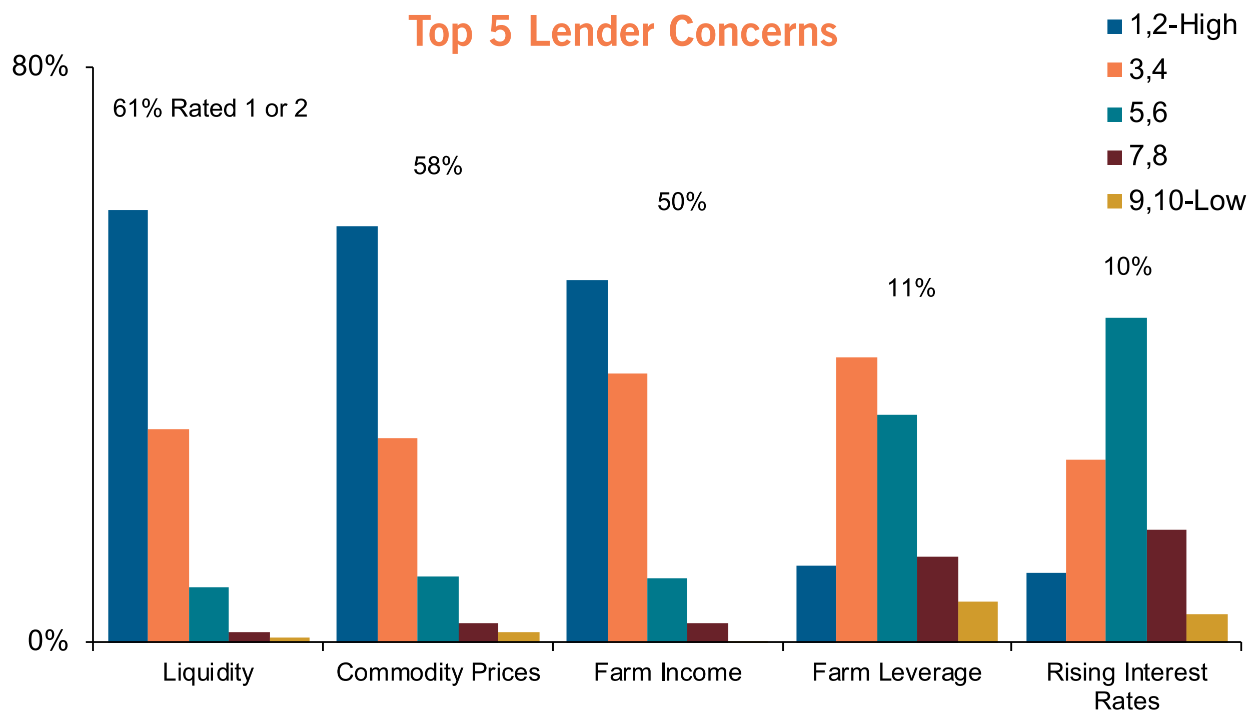
Sentiments improved significantly for the cattle and poultry sectors between June 2017 and August 2018. In the June 2017 ABA-Farmer Mac survey, 40 percent of lenders ranked beef cattle as a top concern for 2017; by August 2018, that percentage fell to 36 percent. Improvements in cattle prices, led by high demand for U.S. beef, paved the way for the improved lender outlook. Lenders also reported improvements in the poultry sector, although the sentiment reported in the June 2017 survey was already positive. The fruits, nuts and vegetable sectors showed little change in lender concern levels between June 2017 and August 2018.

Lender Concerns by Commodity Sector



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q6: Please rate your relative concern for ____ in your area with 1 being the least concern and 5 being the highest concern.

It is not so surprising that lender outlook failed to improve since 2017, given that lenders remain concerned about mostly the same things they cited last year. Four of the top five producer-level concerns in the first half of 2018 involve financial metrics: liquidity, commodity prices, farm income and leverage. The percentage of respondents listing these as a top concern remains virtually unchanged between 2017 and 2018. If anything, financial metrics have loomed even larger as a concern, since concerns about the impacts of rising interest rates supplanted weather concerns from the June 2017 survey. Water, weather and farm labor were not widely reported as a top concern; however, lenders in the West region displayed a heightened response to labor concerns, with a nearly-fullpoint-higher average rating than in the other regions. This highlights the differences in labor costs by region and operation types. Land rents, typically of more concern in the Plains and Cornbelt states (where rent expense climbed dramatically during the agricultural expansion between 2010 and 2014), fell as a concern across all regions, including in the Midwest.



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q3: Please indicate your relative level of concern for the following conditions facing your ag borrowers at this time with 1 being the highest concern and 10 being the least concern.

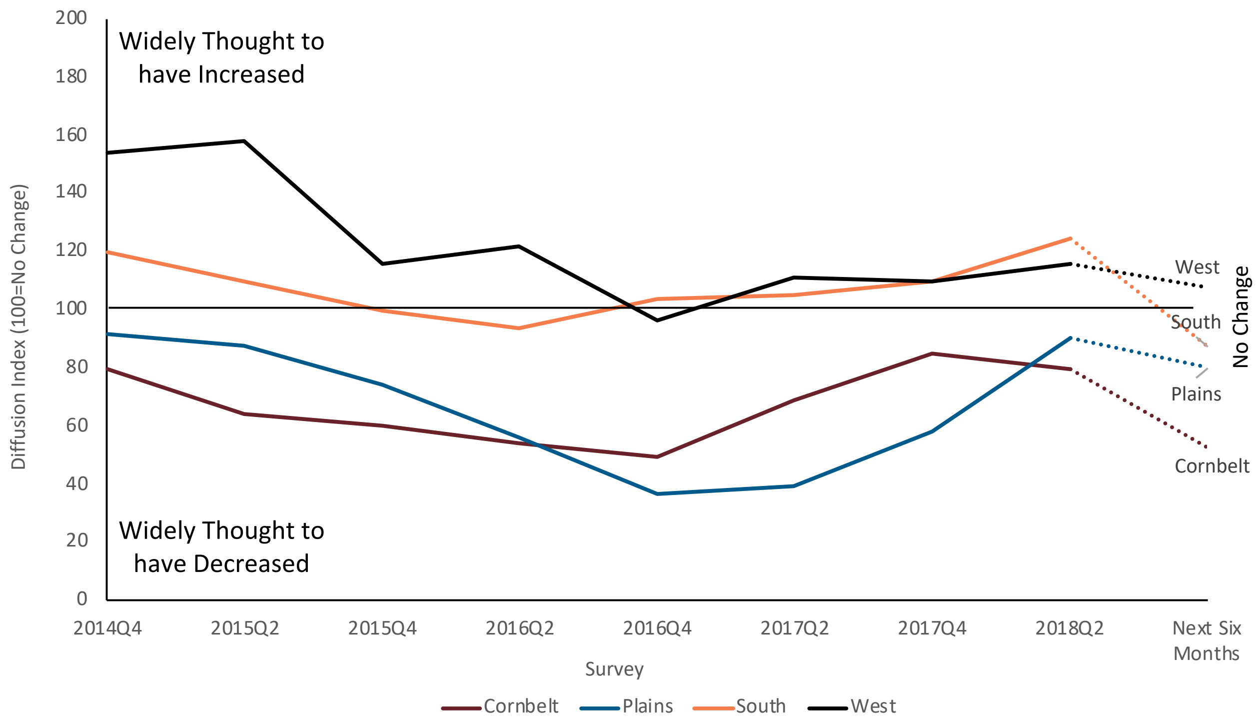
Land Values and Cash Rent Levels

Farmland is an increasingly important component of agricultural industry wealth and borrowing capacity. Real estate represents more than 80 percent of all farm sector assets, and it secures more than $240 billion in mortgage lending.[4] Because many farm acres are partially financed through loans, agricultural lenders must be intune with changes in land markets. Through its earlier surveys, Farmer Mac tracked lender expectations of land markets since 2014, which showed a downward trend. The December 2017 and August 2018 ABA-Farmer Mac surveys show a slight reversal of this trend, with 68 percent of respondents reporting stable values in the first half of 2018, and 54 percent expecting no significant changes in the second half of the year. On average, survey respondents from the December 2017 and August 2018 surveys exhibited more confidence in stable land values than did respondents to the June 2017 survey. The diffusion chart shows the general sentiment trends grouped by region. A diffusion index splits the responses between increase (200), no change (100) and decline (0) and averages the scores to an index of 100. For the Plains region, nearly 46 percent of respondents expect a decrease in average quality-land values in the first half of 2018, with only one respondent of 73 expecting an increase in land values. Thus, the diffusion index for the next six months is

[4]USDA Economic Research Service. Farm Income and Wealth Outlook. https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/

somewhat low at approximately 65. Diffusion index values for all regions came in appreciably higher for the first half of 2018 than in 2017. In August 2018, roughly a quarter of respondents reported a decline in average quality land values in their region during the first six months of 2018 (22 percent), which is substantially lower than the percentage of respondents in December who expected a decline in the first half of the year (38 percent). Results from the USDA's National Agricultural Statistics Service (NASS) annual June Area Survey support these sentiments; the recent Agricultural Land Values report shows a national increase in farmland assets of 1.9 percent in 2018.[5]

Diffusion Index of Land Values by Region



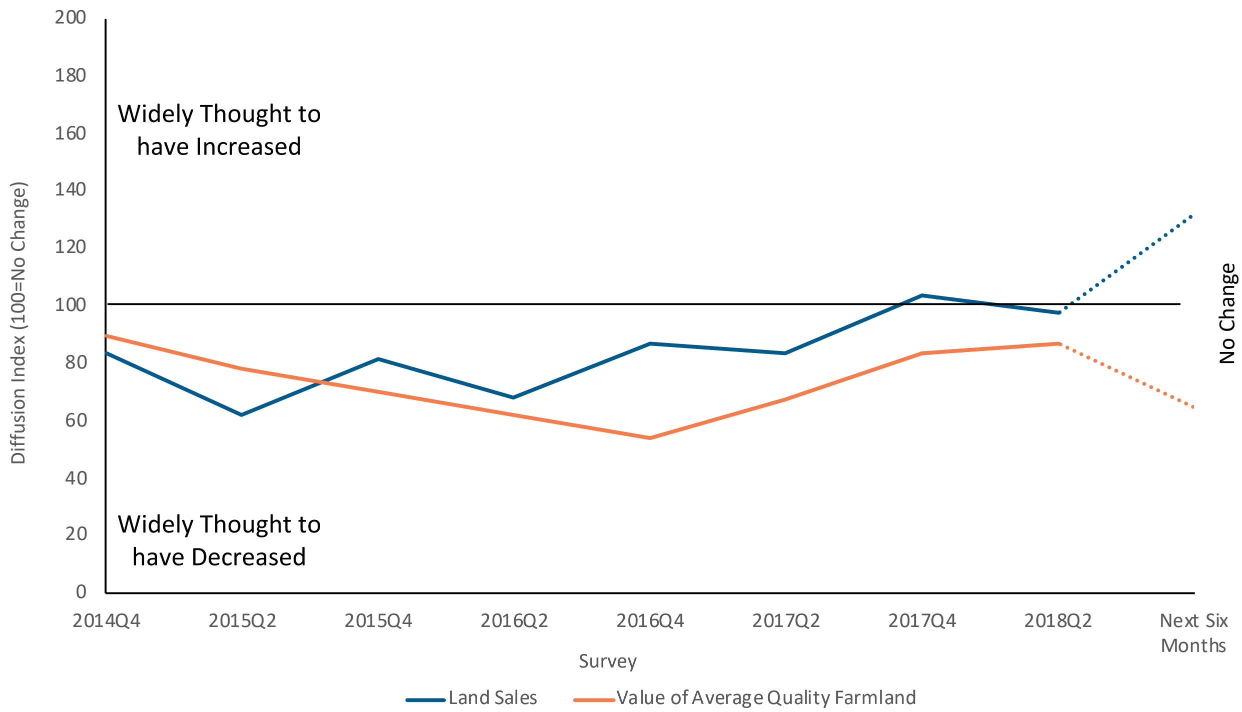
Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018. Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

Lenders have also reported fewer land sale transactions in recent experience. The diffusion index for the number of land sales has been solidly below 100 for the previous two years. That trend reversed in the December 2017 survey, which showed a diffusion index value of approximately 104, indicating a stable number of land sales in the second half of 2017. In a new question, the December 2017 and August 2018 surveys split out land listings from sales;

[5]USDA NASS Agricultural Land Values (August 2017) http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1446

the responses on these two numbers were highly correlated, and the percentage reporting changes were almost identical (68 percent reported that land listings stayed about the same; 70 percent reported that land sales closed remained about the same). Many lenders expect the number of transactions to pick up in the second half of 2018 compared to recent experience, particularly those lenders in the Cornbelt and Plains regions. In total, more than 39 percent of respondents anticipate a higher volume of land sales closed in their areas in the second half of 2018 compared to the first, and approximately 50 percent expect an increase in the number of land listings during that period. Liquidity needs, reduced profitability and an aging customer base are all likely factors in these expectations.

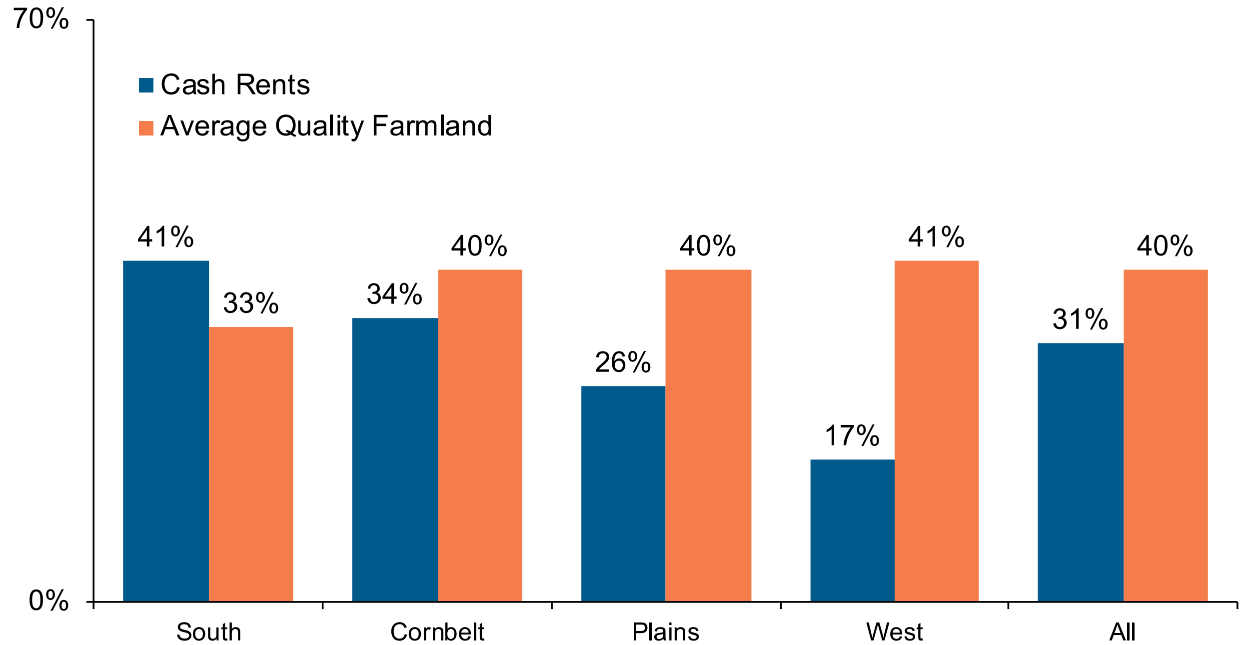
Diffusion Index of Land Sales and Values



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018. Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

To explain the forthcoming declines, most lenders reason that some land values and cash rents are currently overvalued. The average lender reports that a high percentage of average quality land (40 percent) and cash rents (31 percent) are above the fair market value of their area. Land values are perceived as more widely above market values than cash rents, potentially a result of recent declines in negotiated cash rental rates. The most considerable differences between land value and cash rent valuations were in the West region, where lenders indicate that, on average, only 20 percent of acres under rent are above market value, but that approximately 41 percent of land values are overvalued. Respondents from the West regions reported the most significant gains in these numbers since 2016, indicating a rising concern in the valuation of land in those states. Lenders in the Cornbelt region reported the highest percentage of cash rent values overvalued, at 34 percent. Sentiments have not moved significantly since the initial December 2016 ABA-Farmer Mac survey, with the average-reported percentage overvalued declining slightly for farmland assets (from 44 percent) and for cash rents (from 33 percent).

Percentage of Customers' Cash Rent and Land Owned Currently Held Above Market Value



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q8(9): What percentage of your customers' cash rents on average quality farmland (all average quality farmland) would you consider above market value?

Lender Sentiments

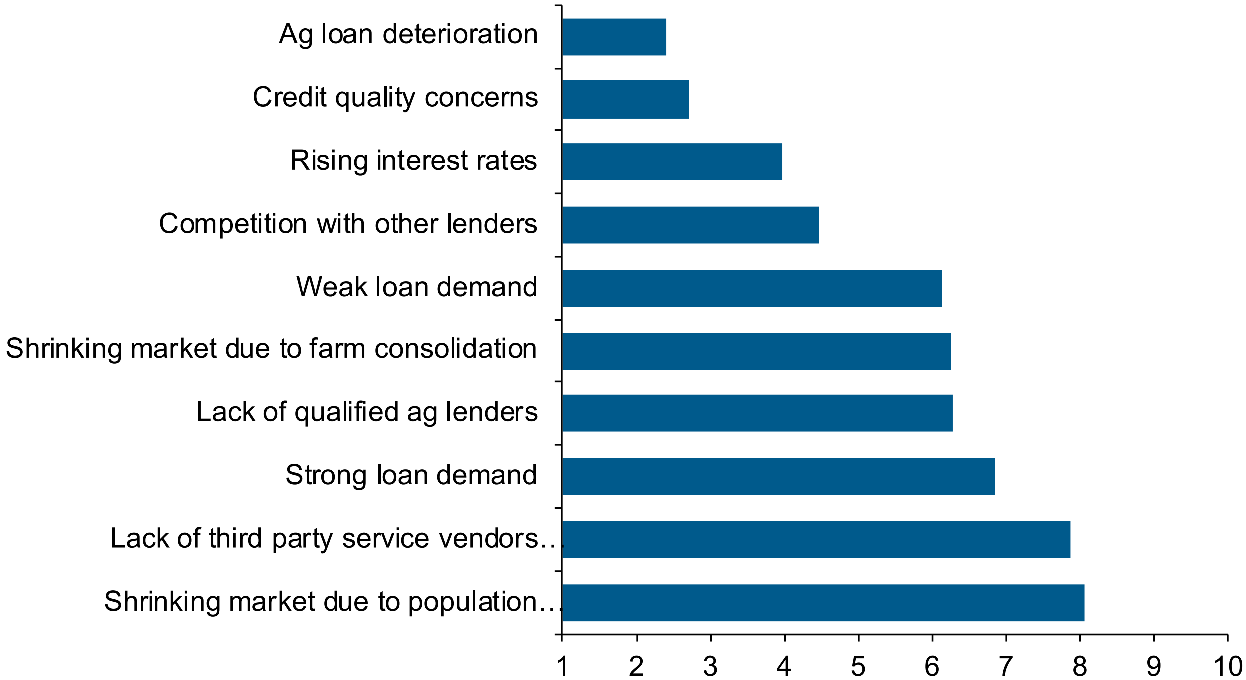
Deterioration of agricultural loans and weakening credit quality are lenders' top concerns facing their institutions, as the farm economy continues to work through a prolonged downturn. However, lenders in the South region were outliers in this regard, identifying competition with other lenders and rising interest rates as their top concerns.

Rising interest rates have been an increasing concern of lenders, and for the first time in two years, it entered the top reported concerns, overtaking the perceived risk of competition with other lenders. Forty-seven percent of lenders rank rising interest rates within their top three areas of concern.

Competition for lending opportunities was also among lenders' top concerns. Most survey participants (75 percent) ranked the Farm Credit System as their top competitor for agricultural loans, followed by community banks, vendor financing and regional banks, in that order. Lenders from the South region reported the highest level of concern regarding competition with other lenders, with 50 percent reporting this as their top concern in the region. Lenders employed by larger financial institutions with assets greater than $1 billion noted the Farm Credit System and community banks as their top competitors with all other competitors having much less impact on their agricultural loan portfolios.

Concern regarding the lack of qualified agricultural lenders was also a prominent concern of lenders, driven by the sentiments of respondents employed by larger financial institutions. Lenders employed by smaller financial institutions were more likely to express greater concern regarding the shrinking agricultural loan markets due to consolidation within the farm sector, and less likely to worry about the lack of qualified agricultural lenders.

Top Concerns Facing Agricultural Lenders



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q4: Please indicate your level of relative concern the following conditions facing your institution at this time with 1 being the highest concern and 10 being the least concern.

During the past six months, lenders were split on the growth of farming operations, with some indicating that farmers were holding operations and debt levels steady, and others indicating that farmers were growing operations or debt levels. The mixture of opinions was shared by lenders across the country and across varying institutional sizes. In the next six months, most lenders expect farmers to increase operations and debt levels (46 percent), a sentiment felt more strongly by those employed by smaller institutions with assets below $100 million (55 percent of these lenders expect growing operations and debt levels among farmers).

Over the past six months, half of lenders (55 percent) reported an increase in demand for agricultural operating loans, while demand for agricultural real estate loans remained unchanged (60 percent). Demand for agricultural operating loans was driven by lenders in the Cornbelt and Plains regions, while demand for agricultural real estate loans was bolstered by lenders operating in the Plains and West regions. In the next six months, survey participants expect demand for agricultural operating farm loans to increase (35 percent). This sentiment is held more strongly by lenders employed by larger financial institutions and by those reporting from the Cornbelt and Plains regions. On the other hand, while a slight majority of lenders expect demand for agricultural real estate loans to remain constant (53 percent), lenders employed by smaller financial institutions were more likely to report anticipating increased demand for such loans.

Half of lenders (50 percent) reported increased vendor financing in their market over the past six months. A sentiment driven by lenders employed by financial institutions with assets above $250 million, as well as those operating in the South and Cornbelt regions. A plurality of lenders (49 percent) expect a continued increase of vendor financing in the next six months.

Lenders remain ready to assist farmers and fulfill credit needs, indicating that, on average, approximately 74 percent of agricultural loan applications received were approved over the last twelve months. Lenders employed at smaller institutions, in general, are more likely to report a higher loan approval rate.

Agricultural Credit Quality

The majority of lenders (82 percent) report a decline in overall farm profitability in the past six months. This sentiment was strongest for those employed at larger financial institutions. The agricultural sector has weakened since a cyclical peak in 2013, and as a result, farm profitability has fallen or held steady for the past five years. While the pace of deterioration has slowed, the sector's weakening has become an ongoing concern for agricultural lenders. While lenders do not report increases in overall farm family expenses, the composition of farmer expenses has shifted, as a large portion of lenders (72 percent) noted farmers facing increasing health care expenses. The agricultural and lending sectors are continually adjusting to new headwinds, and for the moment, credit concerns remain manageable; and well below historical norms. Lenders remain ready to assist farmers through the turbulence of the agricultural economy.

On average, lenders indicated that 51 percent of their agricultural borrowers were profitable in 2017, and they estimate that 51 percent of their total agricultural borrowers will remain profitable through 2018. This is slightly less optimistic than what lenders expressed six months ago. Lenders in the South and West regions were more likely to report a higher percentage of profitable agricultural borrowers in 2017 and moving into 2018.

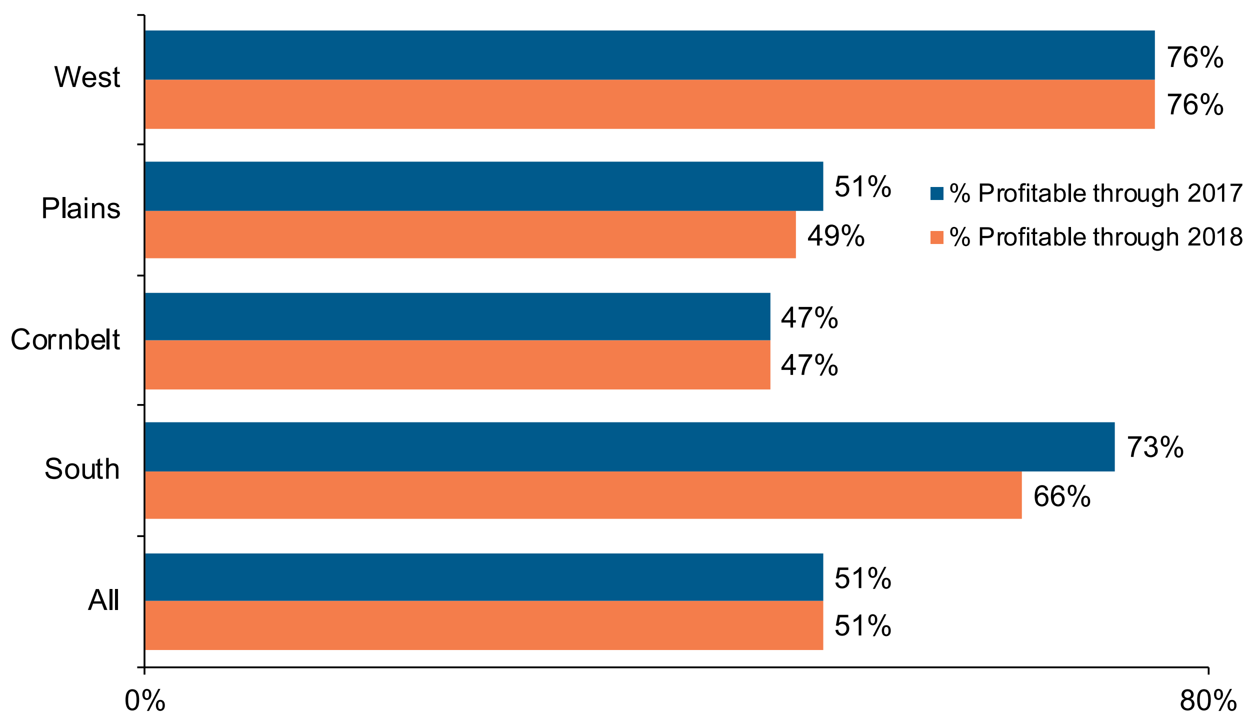
Overall, the vast majority of lenders reported that the credit quality of outstanding agricultural loans (both production and real estate), remained about the same over the past six months, 71 percent and 80 percent, respectively. However, lenders employed by larger financial institutions were more likely to report a sentiment of rising delinquency rates on agricultural real estate loans. Half of lenders (58 percent) expect agricultural production loan delinquency rates to increase over the next six months, while agricultural real estate loan delinquency rates over the same timeframe are expected to remain unchanged (53 percent).

As lenders expect fewer borrowers to remain profitable in the future, half of the lenders (55 percent) noted the increase in the use of government guaranteed loans (USDA FSA and Rural Development loans) over the past six months. And in the next six months, an even larger majority (73 percent) expect the use of government guarantees to increase further. Government guaranteed loans for the agricultural sector have allowed a variety of lenders to ensure credit access for agricultural borrowers across the country who may not have qualified for conventional credit.

Crop insurance is another valuable tool used by farmers across the country. Lenders reported, on average, 95 percent of all agricultural borrowers have some form of crop insurance. Over half of lenders (54 percent) reported crop insurance programs as being their number one area of concern regarding the Farm Bill and its passage. The next top areas of concern included ARC/PLC programs and USDA credit programs. It is imperative that these programs continue to receive funding and staffing to provide support for credit availability to the agricultural sector.

Despite turbulence in the agricultural sector, lenders remain ready to assist farmers and fulfill reasonable credit needs. It will remain essential that agricultural lenders and their institutions maintain healthy, amicable relationships with their primary regulators. Well over half of lenders (83 percent) characterized their relationship with their primary regulator as such, while only a small percentage (4 percent) report an unfavorable, unreceptive, or hostile relationship. However, lenders reported that their regulators have a general lack of comprehension of the agricultural lending sector, which has the possibility to lead to strained relationships in the future. A healthy, knowledgeable, respectful relationship will benefit both the lending institutions and the agricultural sector as a whole.

Percentage of Customers Profitable through 2017 and 2018



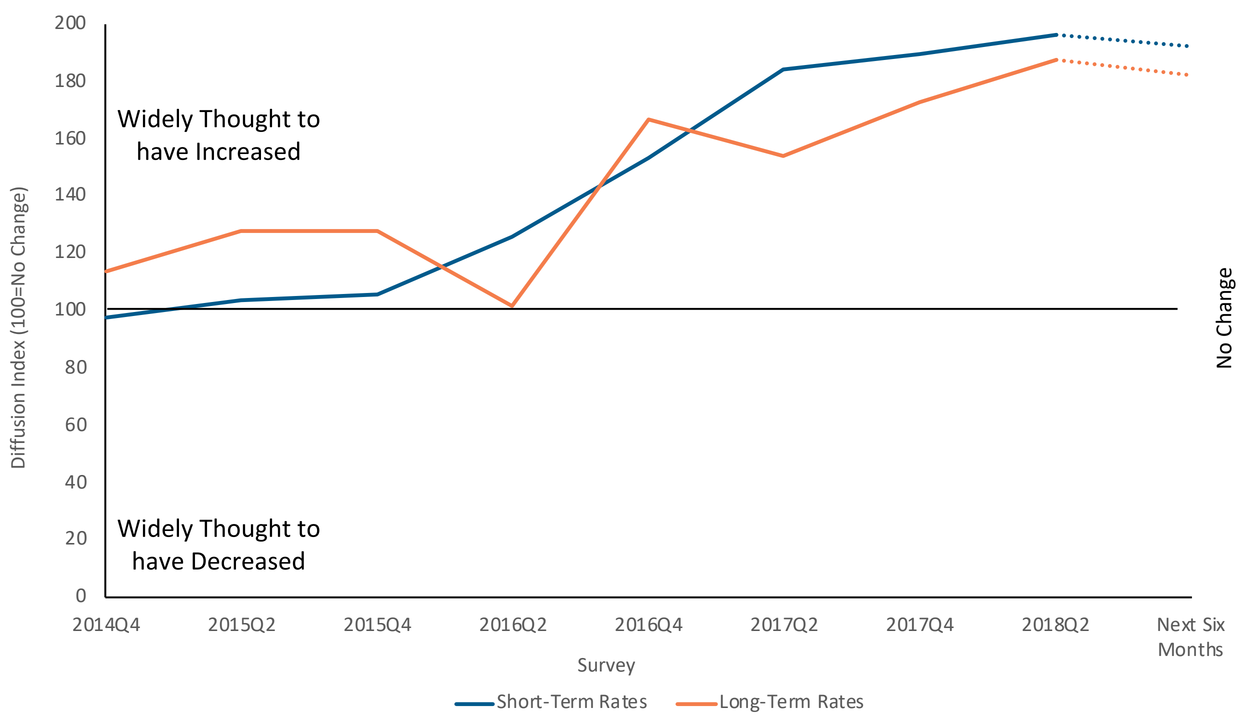
Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q12a/b: What percentage of your ag borrowers are currently profitable?
What percentage of your ag borrowers will remain profitable through 2018?

Interest Rate Environment

Rising interest rates have been an increasing concern of lenders, with 47 percent of lenders ranking rising interest rates within their top three areas of concern. The survey results indicate that the persistently-low interest rates and the inevitable return to a more normal rate environment are on the minds of agricultural lenders, not only from the perspective of the bank's business model, but also out of concern for their agricultural borrowers. As rates rise and begin to return to normal levels, debt financing will become more expensive, and the portion of an agricultural borrower's earnings dedicated to interest payments will increase.

Nearly all lenders reported an increase in short-term (97 percent) and long-term (88 percent) interest rates within their markets over the past six months. Almost all lenders expect that rising interest rate trend to continue, with 92 percent of lenders expecting an increase over the next six months in short-term interest rates and 82 percent in long-term interest rates. This sentiment is held more strongly among lenders employed at larger financial institutions.

Diffusion Index for Interest Rates

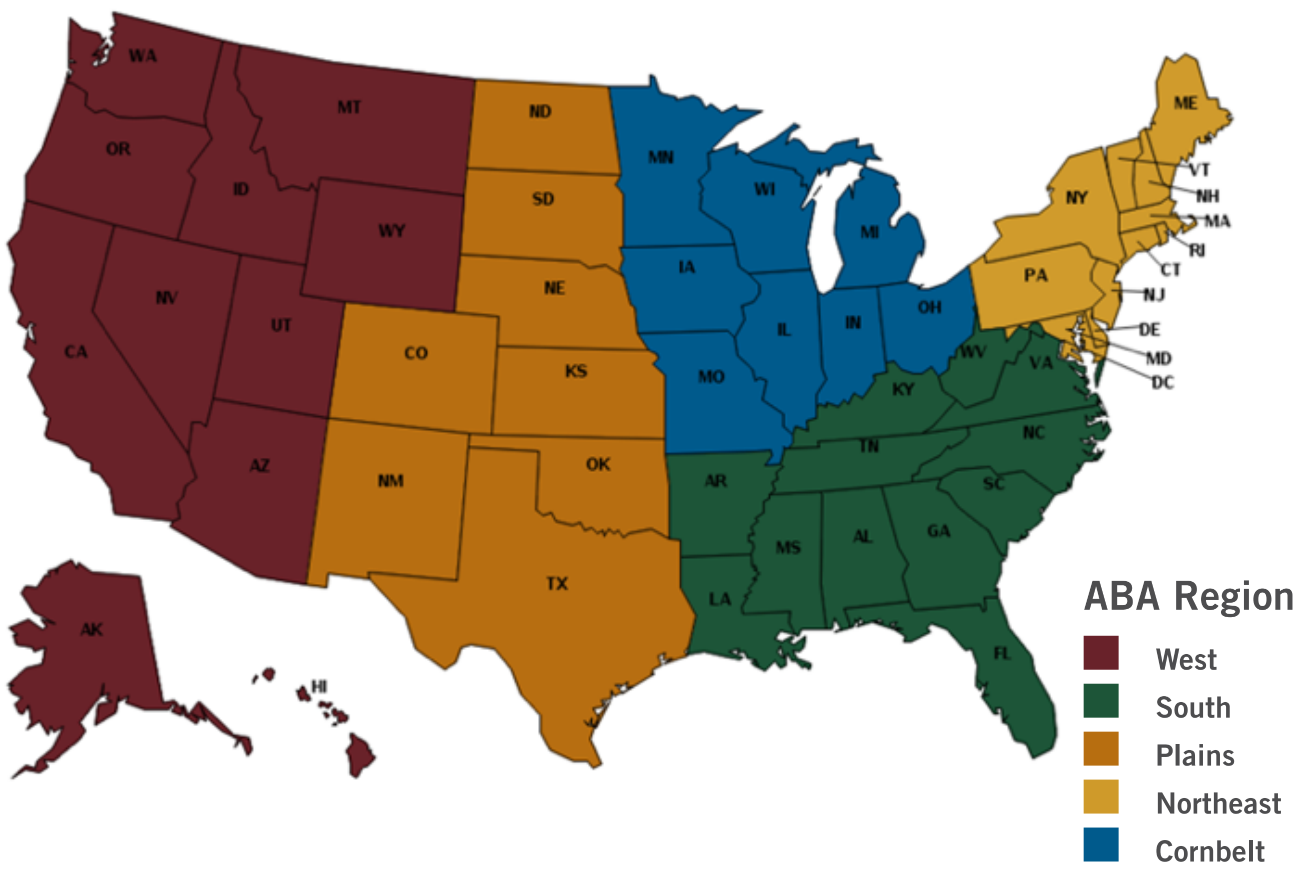


Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018. Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

About the Survey Respondents

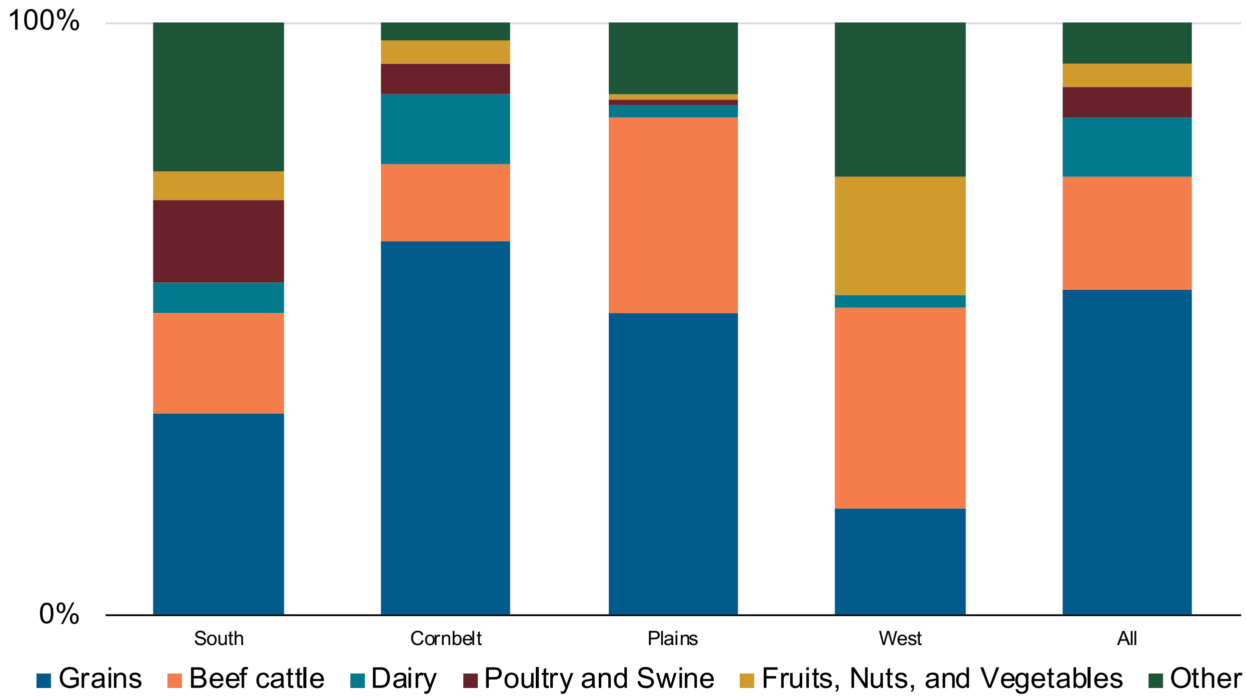
Nearly 350 agricultural lenders completed the ABA-Farmer Mac Agricultural Lender Survey in August. The responses came from a diverse set of institutions, ranging from those with under $50 million in assets to those with more than $5 billion in assets. Approximately two-thirds of the responses came from lenders at institutions with $500 million or less in assets (67 percent). Regionally, the responses were somewhat concentrated in the Cornbelt states (64 percent), which is expected given the high proportion of agricultural production and lending that occurs in those states.

ABA Regions



Lender portfolios tended to be highly concentrated in grains and cattle, but there was some diversity by region. Respondents in the West reported a higher percentage of cattle, fruits and nuts, and vegetables than other regions. Lenders responding from the South note a relatively-higher proportion of poultry and other crops, including cotton, peanuts, and hay. These portfolio weights line up well with regional productive capabilities.

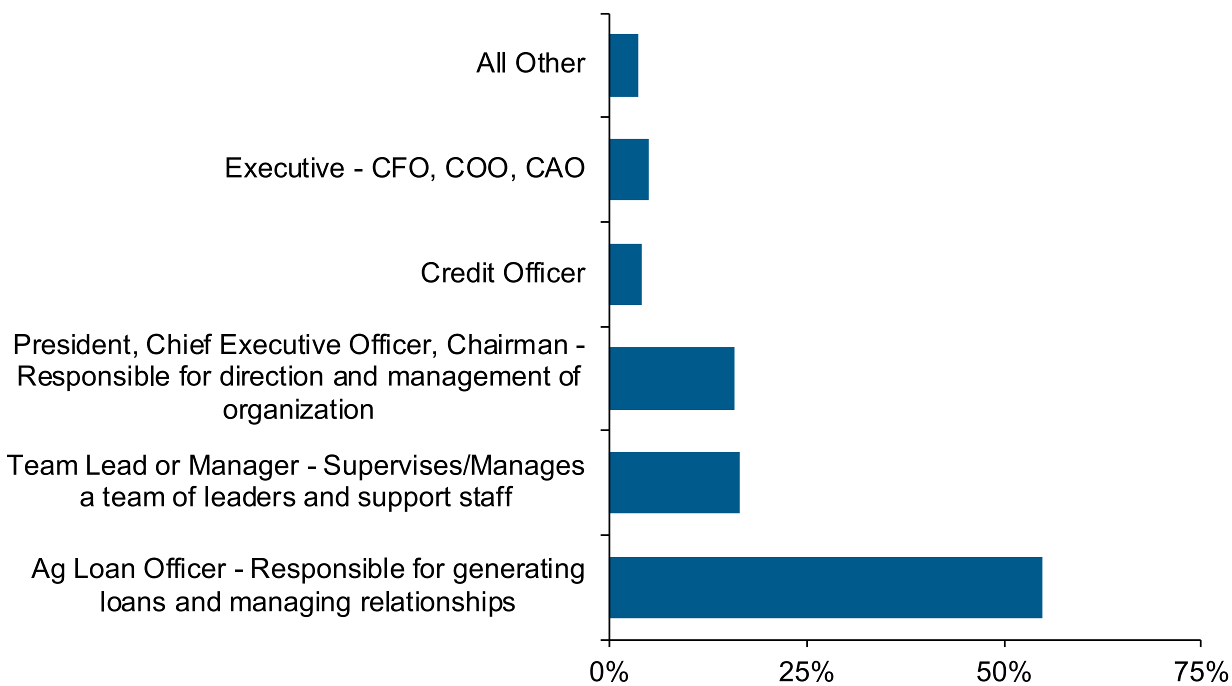
Lender Portfolios Vary by Region



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q5: What percentage of your agricultural credit portfolio is in the following?

Survey respondents had a variety of roles at their respective institutions. The most common title or role reported was an agricultural loan officer (55 percent). Others reported team manager roles, senior executives and credit officers.

Survey Respondent Job Responsibilities



Source: ABA-Farmer Mac Agricultural Lenders Survey August 2018
Mean response to Q20: What is your role at your institution?

About ABA and Farmer Mac

The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits, and extend nearly $10 trillion in loans.

Farmer Mac is a vital part of the agricultural credit markets and was created to increase access to and reduce the cost of capital for the benefit of American agricultural and rural communities. As the nation's premier secondary market for agricultural credit, we provide financial solutions to a broad spectrum of the agricultural community, including agricultural lenders, agribusinesses and other institutions that can benefit from access to flexible, low-cost financing and risk management tools. Farmer Mac's customers benefit from our low cost of funds, low overhead costs and high operational efficiency. In fact, we are often able to provide the lowest cost of borrowing to agricultural and rural borrowers. For more than a quarter-century, Farmer Mac has been delivering the capital and commitment rural America deserves. Additional information about Farmer Mac is available on Farmer Mac's website at www.farmermac.com.

ABA and Farmer Mac have been working together for more than a decade to offer the financial and educational tools bankers need to serve their agricultural customers.