Summer 2017

AGRICULTURAL LENDER SURVEY RESULTS

FARMER MAC

American Bankers Association®

Contents

Key Takeaways

- In general, lender sentiment improved slightly from December 2016 to June 2017, exhibited by fewer respondents reporting farm profitability declines, increases in farm leverage, and increases in alternative/vendor financing.
- Grains and dairy remained the sectors that lenders are most concerned about, while lenders reported less concern for the cattle and hog sectors in the first half of 2017.
- Customer financial health continued to dictate lender unease at the borrower level—commodity prices, liquidity positions, income levels, and financial leverage remain the top four concerns in the first half of 2017. Weather uncertainty moved into the top five lender-reported customer concerns.
- Lender sentiment on land values ticked up in 2017, with fewer respondents reporting declines in land values compared to December 2016. This trend was consistent across all regions. Many lenders expect the pace of land transactions to quicken in the second half of 2017 (30 percent), but the majority expect the pace to remain steady (63 percent).
- The average agricultural lender expected 52 percent of their customers to be profitable in 2017, a drop of two percentage points from December 2016.
- Portfolio credit quality and competition topped lender business concerns in early 2017.
- Lenders surveyed reported an average agricultural loan approval rate of 84 percent in the 12 months before June 30, 2017.
- Nearly half of lenders (49 percent) described their relationship with their primary regulator amicable and approachable.
- Virtually all respondents expected short-term interest rates to rise in the second half of 2017 (85 percent), and a wide majority of respondents expected long-term interest rates to rise as well (71 percent).

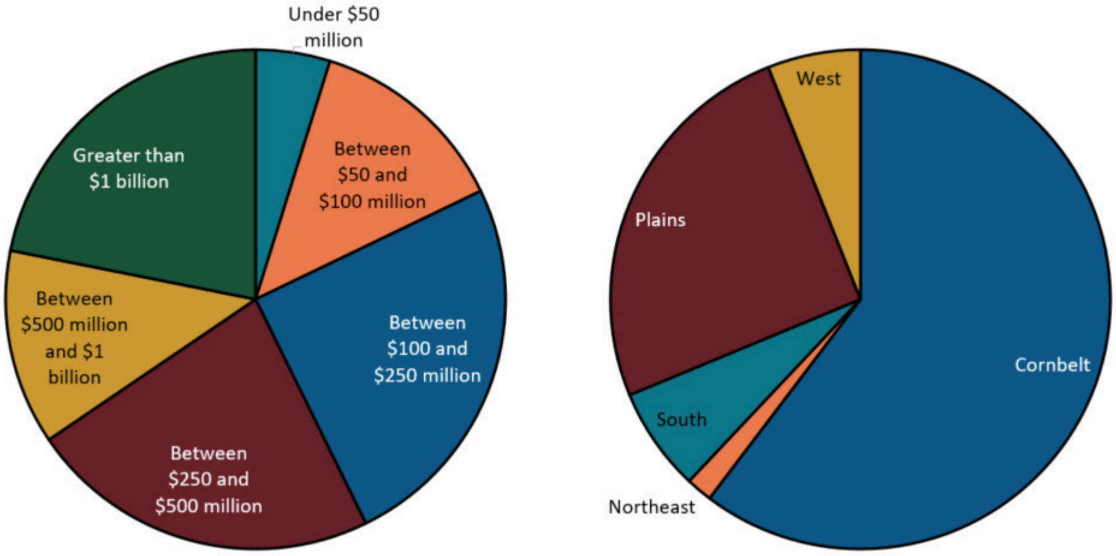
Introduction

Agricultural lenders offer a unique perspective on conditions in the agricultural economy. Producers who use short- or long-term financing are routinely required to present financial updates to their loan officers, positioning lenders with the unique 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 its first joint survey of agricultural lenders to gauge overall industry sentiment on the farm economy, expectations on land values, prospects for 2017 and issues facing the broader economy. The second lender survey, issued during June 2017, is designed to reassess lender sentiments midyear. Both studies expand upon data collected by Farmer Mac in prior years.

The survey was distributed via email between June 12, 2017, and June 30, 2017. More than 580 loan officers, managers, and executives responded to the questionnaire. Responses represent a range of institutions by asset size—from less than $50 million in assets to more than $5 billion—and geography. This analysis breaks down results by general agricultural economic insights and factors affecting lending institutions. The report concludes with a broader description of the respondent demographics.

Respondent Size and Primary Market Region



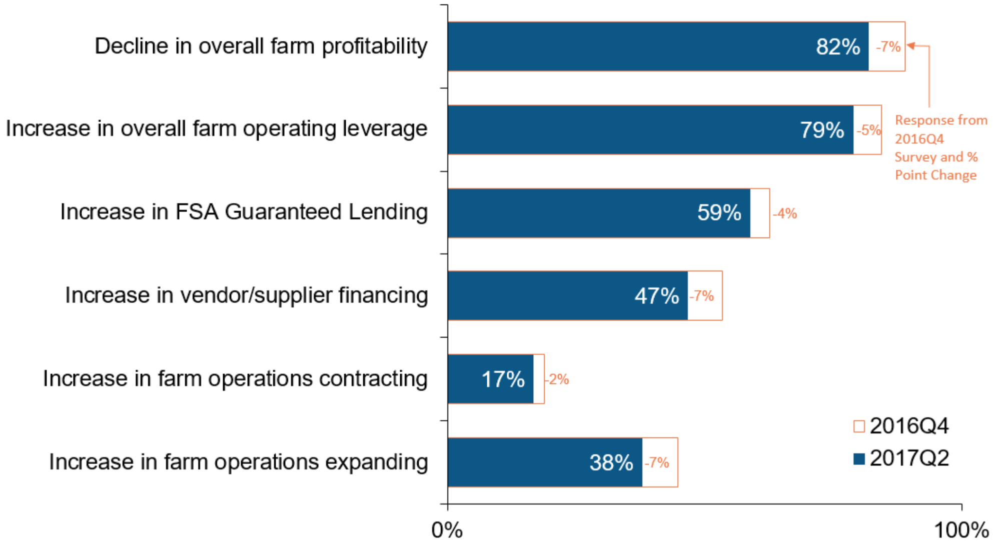
Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017

Agricultural Economy

Farm Profitability and Economic Conditions

During the first half of 2017, agricultural lenders report improving sentiments on the overall agricultural economy. While a high percentage of respondents reported an overall decline in farm profitability in the last six months (82 percent), that percentage is down more than seven points since the December 2016 ABA-Farmer Mac survey. Similar improvements were recorded in most categories, including the percentage reporting higher levels of operating leverage (79 percent down from 84 percent reported in 2016) as well as increased usage of the Farm Service Agency's (FSA) Guaranteed Loan program (59 percent down from 63 percent reported in 2016). Lenders also reported a shrinking percentage of farms expanding (38 percent down from 45 percent reported in 2016), but also a declining proportion of farm operations contracting (17 percent down from 19 percent reported in 2016). The responses indicate that a portion of lenders are sensing improving economic conditions, while at the same time observing an increasing number of farm operators delaying major structural decisions. These findings support recent analysis released by 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] Looking to 2017, lenders expect 52 percent of their customers to remain profitable, a slight decline from 2016, and virtually unchanged from the December 2016 ABA-Farmer Mac survey (54 percent).

Agricultural Lenders' Observations



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

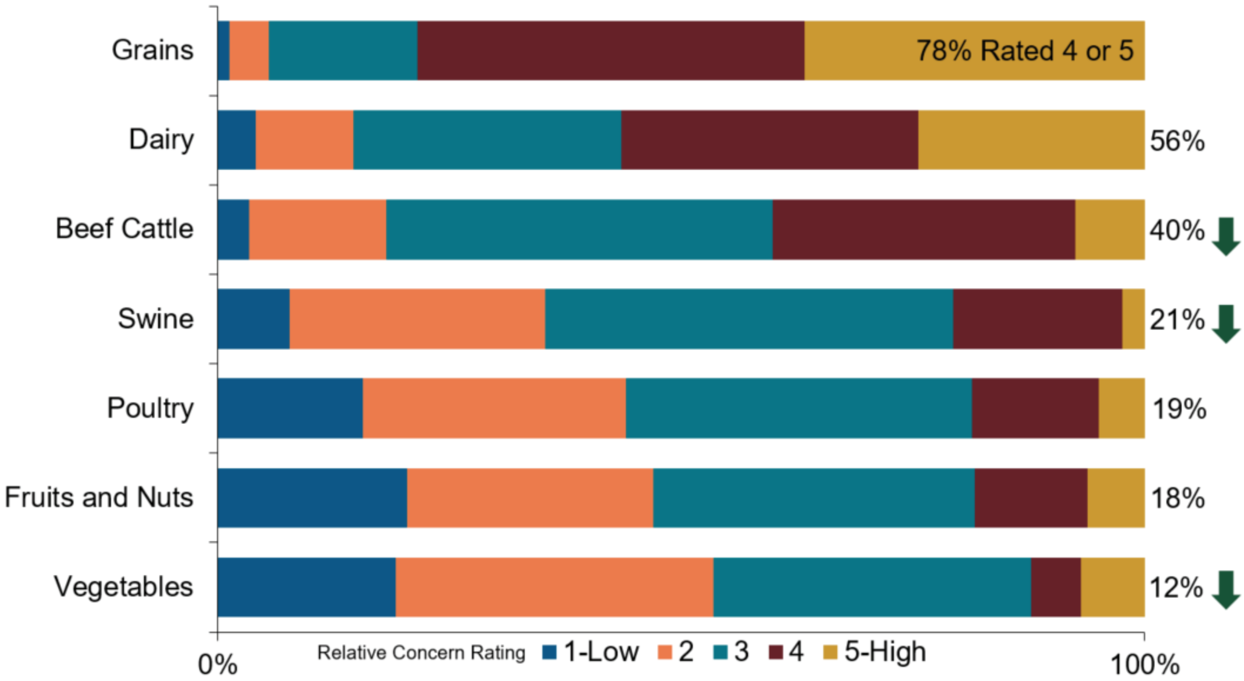
1 USDA Economic Research Service. Farm Income and Wealth Outlook. https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/

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

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, soybeans, and wheat, where market prices remain near cyclical lows. Growers in the West and South regions produce more specialty crops that are less subject to swings in commodity markets.

At the commodity sector level, commodity crops and dairy products are a top concern 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 grains, dairy, and beef cattle among their top concerns. Just under 80 percent of all respondents rate the grain sector as a top concern, compared to just 18 and 12 percent for the fruit and nut, and vegetable sectors, respectively. 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 Concerns by Commodity Sector



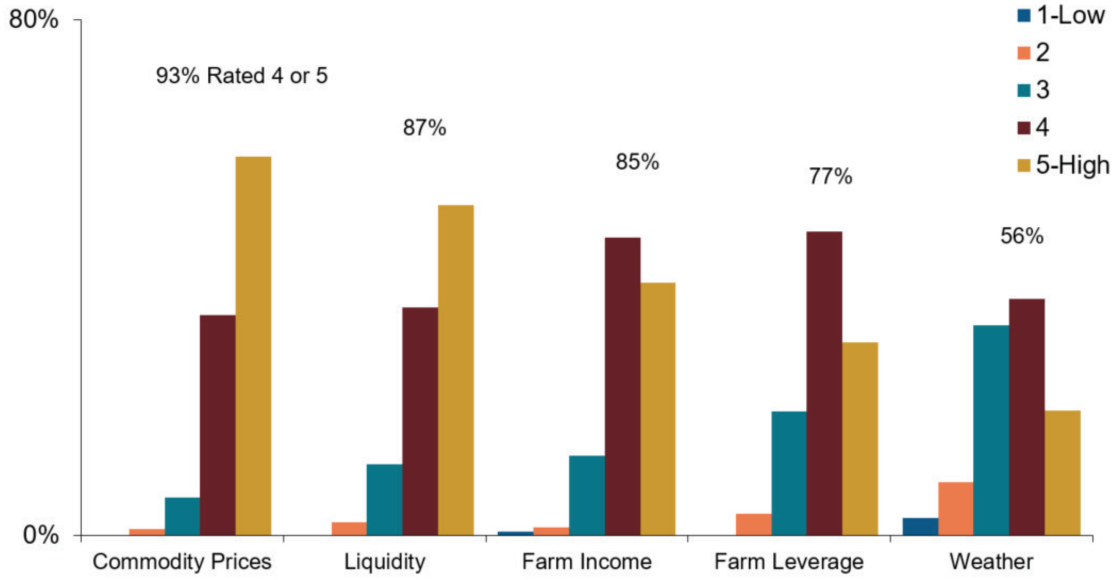
Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017
Mean response to Q6: Please rate your relative concern for_____ in your area with 1 begin the least concern and 5 being the highest concern

[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 hog sectors between December 2016 and June 2017. In the December ABA-Farmer Mac survey, 63 percent of lenders ranked beef cattle as a top concern for 2017; by June 2017, that percentage fell to 40 percent. Improvements in cattle prices led by high demand for U.S. beef paved the way for the improved outlook by lenders. The hog sector had a similar decline, falling from 40 percent in December to 21 percent in June. Strong demand for U.S. pork elevated hog prices in the first half of 2017, giving the sector a boost in the eyes of lenders. Lenders also reported improvements in the vegetable sectors, although the sentiment reported in the 2016 survey was already positive. The grains, dairy, poultry, and fruits and nuts sectors showed little change in lender concern levels between December and June, which aligns with the limited change in market fundamentals for those segments in the first half of 2017.

While the overall sentiment may have improved slightly in the first half of 2017, the drivers of industry stress remain the same. Four of the top five producer-level concerns involve financial metrics: commodity prices, liquidity, farm income, and leverage. The percentage of respondents listing these as a top concern remains virtually unchanged between December and June. Weather concerns crept into the top five in the June survey, supplanting land rents. Persistent dryness during much of the spring and summer months in the upper Midwest is likely the driver of the heightened concern. Farm labor and availability are not widely reported as a top concern; however, lenders in the West region display a heightened response to labor concerns with nearly a full point higher average rating than the other regions. This highlights the regional differences in labor costs by region and operation types. Land rents are of more concern in the Plains and Cornbelt states where rent expense climbed dramatically during the agricultural expansion between 2010 and 2014.

Top 5 Lender Concerns

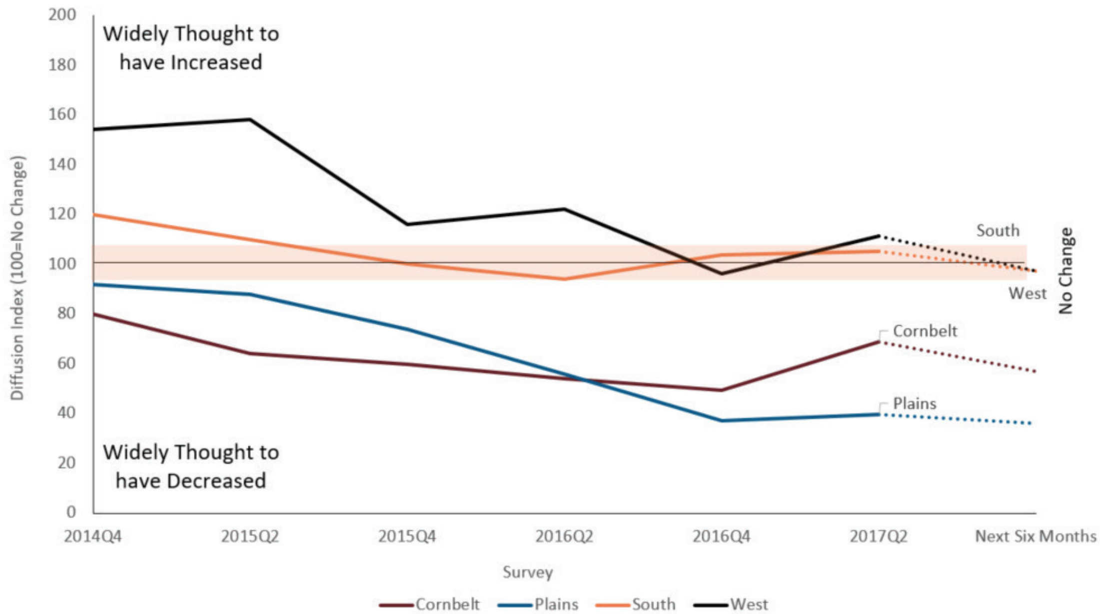


Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017
Mean response to Q3: Please indicate your relative level of concern for the following conditions facing your ag borrowers at this time with 1 being the lest concern and 5 being the highest concern

Land Values and Cash Rent Levels

Farmland represents 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 $200 billion in mortgage lending.[4] Because many farm acres are at least partially financed through loans, agricultural lenders must be in-tune with changes in land markets. Through a previous survey, Farmer Mac tracked lender expectations of land markets since 2014, which showed a downward trend. The June 2017 ABA-Farmer Mac survey shows a slight reversal of this trend, with 57 percent of respondents reporting stable values in the first half of 2017, and 51 percent expecting no major changes in the second half of 2017. On average, survey respondents from the June survey exhibited more confidence in stable land values than respondents to the December survey. The diffusion chart shows the general downward trend segregated 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 64 percent of respondents expect a decrease in average quality land values in the latter half of 2017 with no respondents expecting an increase. Thus, the diffusion index for the next six months is relatively low at 36.

Diffusion Index of Land Values by Region



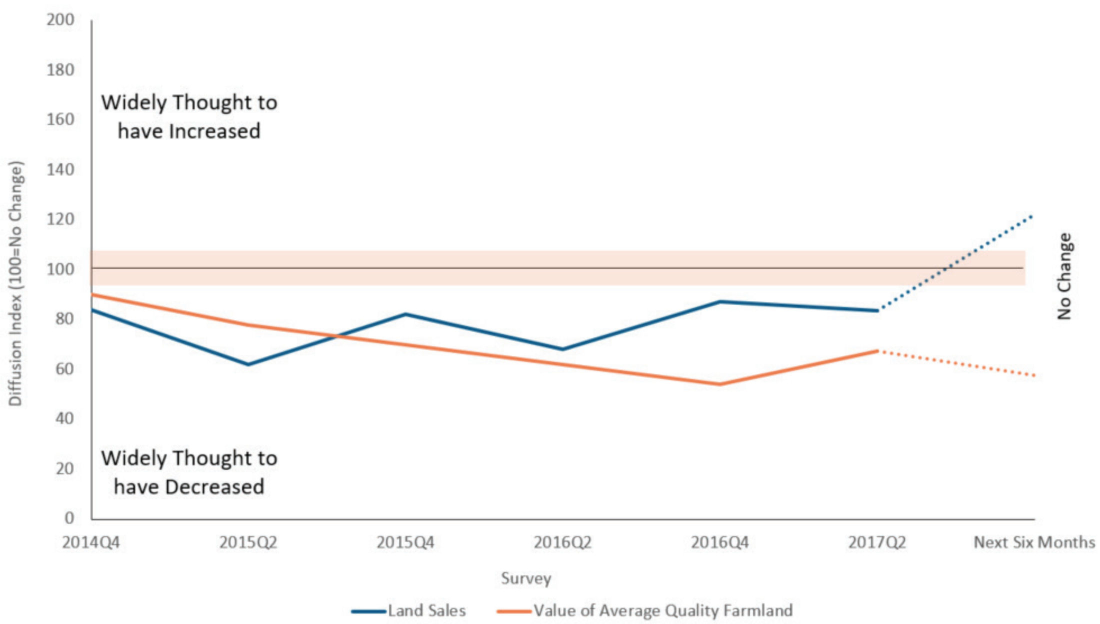
Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

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

Diffusion index values for all regions came in appreciably higher for the first half of 2017 than lenders expected last December. In June, approximately a third of respondents reported a decline in average quality land values in their region during the first six months of 2017 (38 percent), which is substantially lower than the percentage of respondents in December who expected a decline in the first half of the year (57 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 2.3 percent in 2017.[5]

As with land values, lenders also report lower volumes of land sales in the last few years. The diffusion index for the number of land sales has been solidly below 100 for the last two years. Many lenders expect the number of transactions to pick up in the second half of 2017 compared to recent experience, particularly those lenders in the Plains region. In total, more than 30 percent of respondents anticipate a higher volume of land sales in their areas in the second half of 2017 compared to only 8 percent that expects land sales to slow. Lower land prices, reduced profitability, and an aging customer base are all likely at play in these expectations.

Diffusion Index of Land Sales and Values

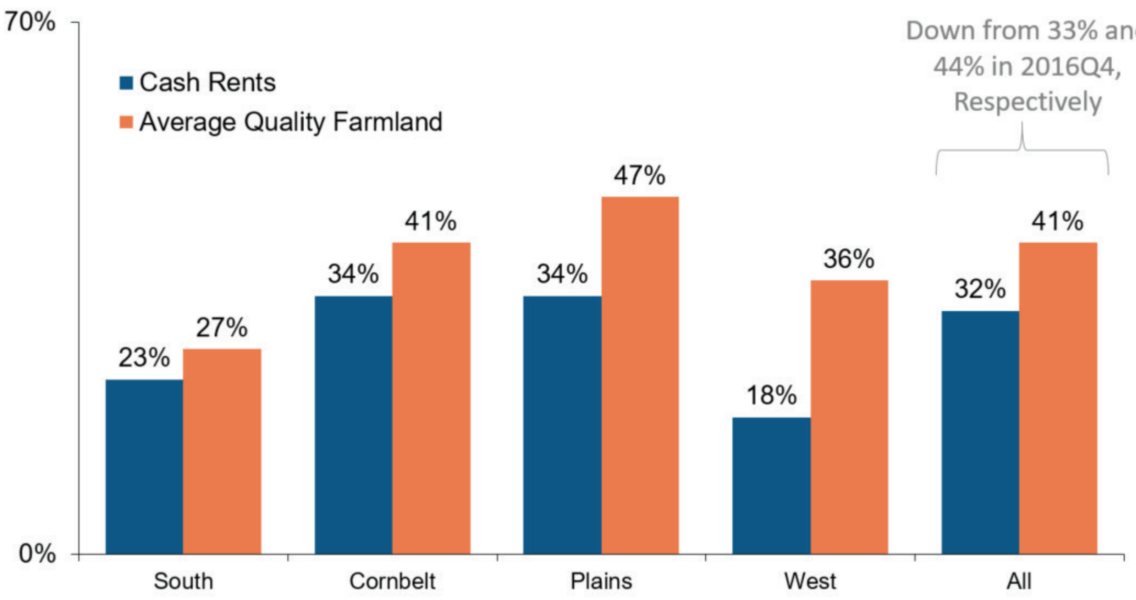


Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

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

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 (41 percent) and cash rents (32 percent) are above 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 largest discrepancies between land value and cash rent overvaluation are in the West region where lenders indicate on average only 18 percent of acres under rent are above market value but approximately 36 percent of land values are overvalued. Lenders in the Plains region report the highest percentage of land values overvalued (47 percent); about 58 percent of respondents in the Plains region feel that three or more of every five acres in their area are overvalued. Sentiments have improved slightly since the December ABA-Farmer Mac survey, with the average reported percentage overvalued declining for both farmland assets (from 44 percent) and cash rents (from 33 percent).

Owned Currently Held Above Market Value



Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Mean response to Q8(9): What percentage of your customers' cash rents on average qualify farmland (all average qualify farmland) would you consider above market value?

Lender Sentiments

Credit quality and deterioration of agricultural loan are lenders' top concerns facing their institutions. Not unexpectedly lenders across the country expressed these concerns as the agricultural economy continues to work through a prolonged downturn.

Competition from other lenders was also among lenders' top concerns facing their institutions, particularly in the South where over 50 percent of lenders surveyed identified competition from other lenders among their top concerns. Most lenders (75 percent) ranked the Farm Credit System as their top competitor for agricultural loans, followed by community and regional banks.

Some lenders surveyed noted concerns regarding loan demand. On the one hand, a few lenders indicated that heavy loan demand has forced institutions against their lending caps. On the other hand, others noted that consolidation of the farm economy due to the lack of individuals available to replace retiring farmers could lead to weakening loan demand.

The lack of qualified agricultural lending staff was also a prominent concern lenders felt their institutions were facing. This perception was most aggressively reported by lenders in the West. There are a variety of specialty crops farmed in the West and lending to such crops requires specific knowledge that may make it difficult to identify and recruit potential new employees. In addition, these specialty crops are less likely to have access to crop insurance, adding to the uncertainty a lender must work through and requiring additional expertise to perform the lending role.

Top Concerns Facing Agricultural Lenders

Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Mean response to Q4: Please indicate your level of relative concern the following conditions facing your institution at this time

Just more than half of the lenders surveyed reported that farm operations and debt levels remained consistent over the past six months, while the remaining lenders noted an increase in debt levels. This mixture of opinions was shared by lenders across the country and institutional size.

During the past six months, the majority of lenders (51 percent) noted an increase in the demand for agricultural operating loans, while no notable change in the demand for agricultural real estate loans was observed (57 percent). In the next six months, the majority of lenders (53 percent) expect a continued increase in agricultural operating loan demand, while the majority of lenders (60 percent) expect demand for agricultural real estate loans to remain unchanged. Lenders in the Plains are more optimistic about increased demand for agricultural loans relative to peers.

While lenders employed by institutions with assets greater than $1 billion were more likely to be concerned about weak loan demand relative to others, overall lenders expressed little concern about weak loan demand. Only four percent of lenders indicated weak loan demand as the top concern facing their institution. On the contrary, some lenders indicated the opposite – strong loan demand was a rising threat to their institutions.

Many lenders (47 percent) indicate vendor lending increased over the past six months. This result was driven by responses from lenders in the Cornbelt, with 51 percent responding that vendor financing had increased over the past six months. Lenders in other geographic regions were more likely to indicate that vendor financing remained about the same over the past six months. Lenders indicate that their greatest competitor for agricultural loans was the Farm Credit System, followed by community and regional banks. The responses indicate that credit unions and insurance companies are not primary competitors in the agricultural lending area.

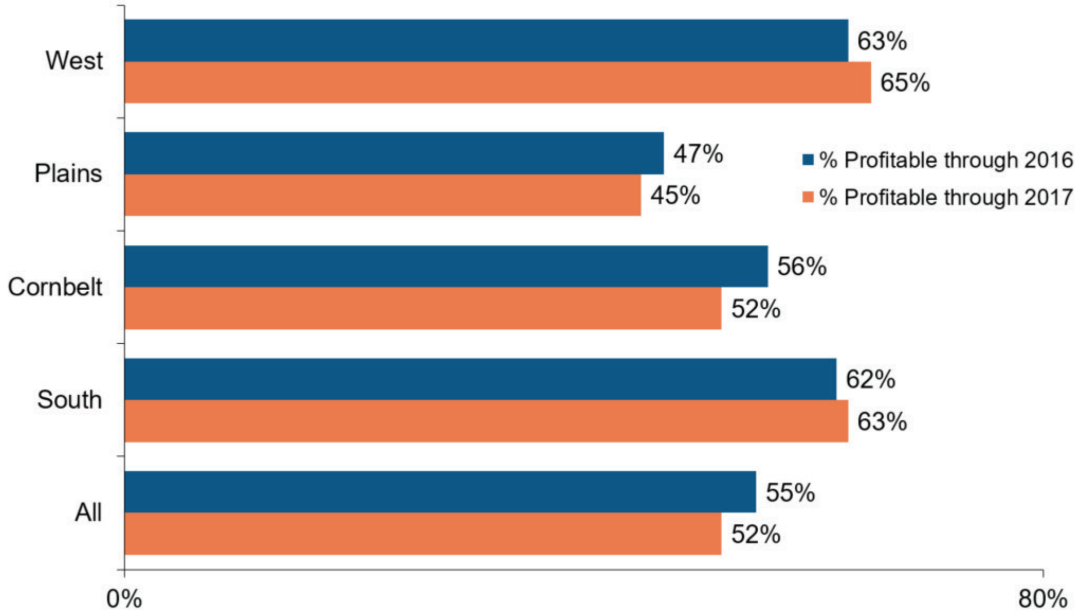
Lenders remain ready to assist farmers and fulfill credit needs, indicating on average approximately 84 percent of agricultural loan applications received were approved over the last twelve months. Lenders employed at smaller institutions, in general, are more likely to report a higher loan approval rate.

Agricultural Credit Quality

The majority of lenders surveyed (82 percent) reported a decline in overall farm profitability in the past six months. This perception was strongest among lenders employed by institutions with assets under $1 billion, while lenders in the South region observed less of a decline than other areas. The agriculture sector has weakened over the past several years, and as a result, farm profitability has fallen consistently. While the pace of deterioration has slowed, the sector's weakening has become an ongoing concern for agricultural lenders as repayment rates begin to decline and the threat of asset quality deterioration increases. However, credit concerns remain manageable, well below historical norms, and lenders remain ready to assist farmers through any turbulence in the agricultural economy.

On average, lenders indicated that 55 percent of their agricultural borrowers were profitable in 2016, and estimate that 52 percent of their total agricultural borrowers will remain profitable through 2017. This perception is only slightly less optimistic than lenders expressed six months ago. Lenders in the South and West reported most of their customers were profitable in 2016 (62 and 63 percent, respectively), and that the majority will remain profitable in 2017 (63 and 65 percent, respectively). That contrasts to lenders in the Cornbelt and Plains regions where only a slim majority were profitable in 2016 (56 and 47 percent, respectively) and will remain profitable in 2017 (52 and 45 percent, respectively). Lenders in the Plains expressed greater concern regarding agricultural loan deterioration relative to other regions.

Percentage of Customers Profitable through 2016–2017



Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Mean response to Q11 a/b: What percentage of your ag borrowers are currently profitable? What percentage of your ag borrowers will remain profitable through 2017?

Because lenders expect fewer customers to be profitable in 2017 and are increasingly concerned about loan repayment, most survey respondents noted an increase in the use of government guaranteed loans (FSA loans) over the past six months (59 percent). 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. It is imperative that these programs continue to receive funding and staffing to provide a foundation of credit availability to the sector.

Despite turbulence in the agricultural sector, lenders remain ready to assist farmers and fulfill credit needs. It will remain imperative that agricultural lenders and their institutions maintain a healthy, amicable relationship with their primary regulators. Just under half (49 percent) of lenders characterized their relationship with their primary regulator as such, while only a small percentage (6 percent) reports an unfavorable, unreceptive, or hostile relationship. This relationship will benefit both the lending institution and the agricultural sector as a whole.

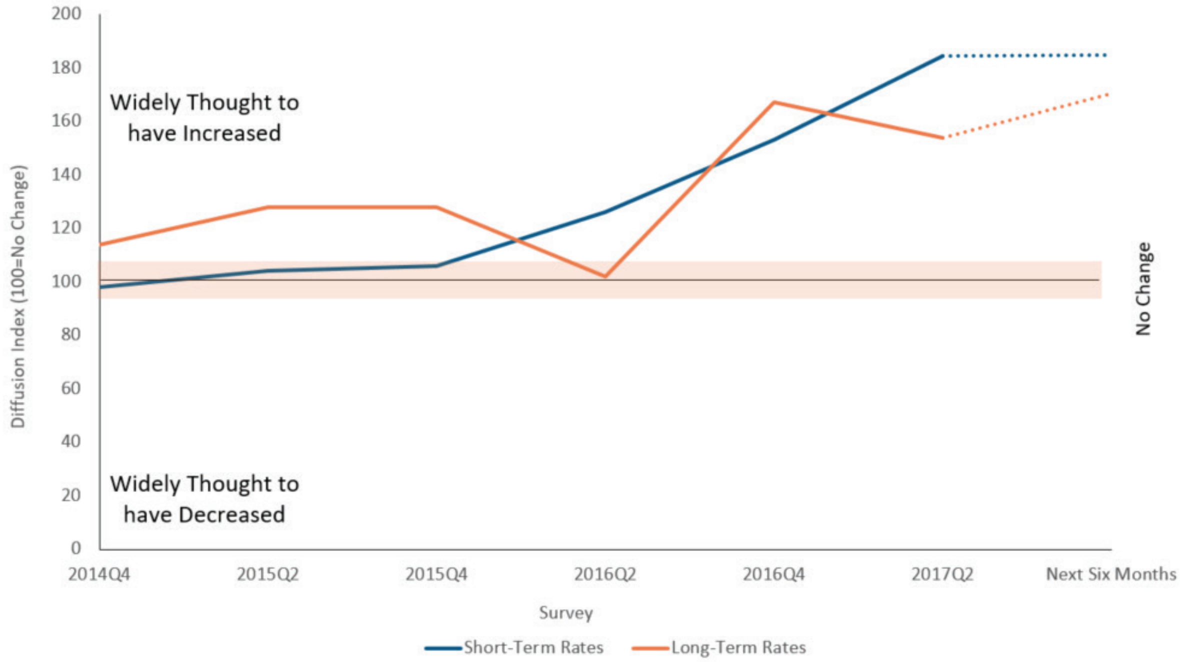
Interest Rate Environment

Persistently low interest rates and the inevitable return to a more normal rate environment is on the mind of both agricultural lenders and 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. Lenders must consider this when determining lending lines.

Most of the survey respondents (84 percent) observe that short-term interest rates increased over the past six months. Lenders at institutions with assets greater than $250 million in assets were more likely to report increases in short-term interest rates relative to peers. Furthermore, the clear majority of lenders (85 percent) expect short-term interest rates to continue to increase in the next six months. A lesser majority of respondents (56 percent) observed that long-term interest rates increased over the past six months. In the next six months, there are greater expectations (71 percent of respondents) that long-term interest rates will increase. Larger institutions drive this sentiment.

The Federal Reserve's Federal Open Market Committee has begun the inevitable return to a more normal rate environment, increasing the target federal funds rate range to 1 to 1.25 percent over the span of several board meetings. The movement in interest rate expectations in the latest survey indicates lenders are more convinced of a rate increase than they have been in previous years.

Diffusion Index for Interest Rates

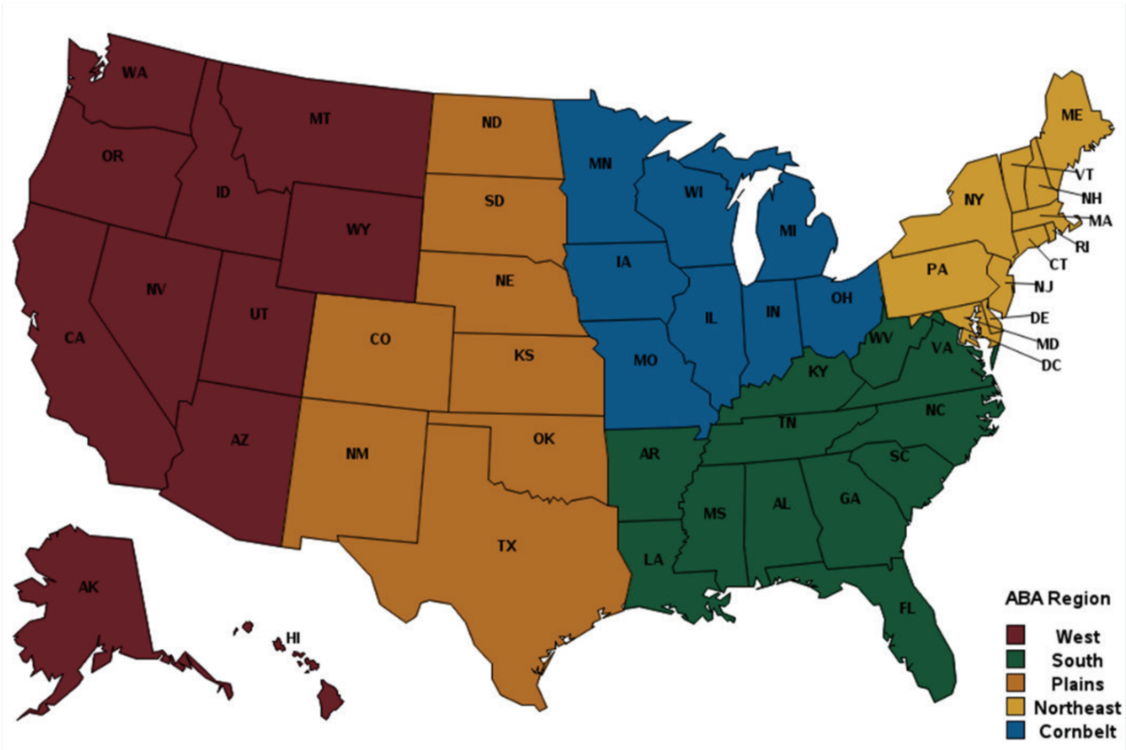


Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
Prior to 2016Q4, results from Farmer Mac internal surveys provided for trend.
Mean response to Q1/Q2: During the past 6 months, how have the following economic conditions changed in your area? How much will they change in the next 6 months in your area?

About the Survey Respondents

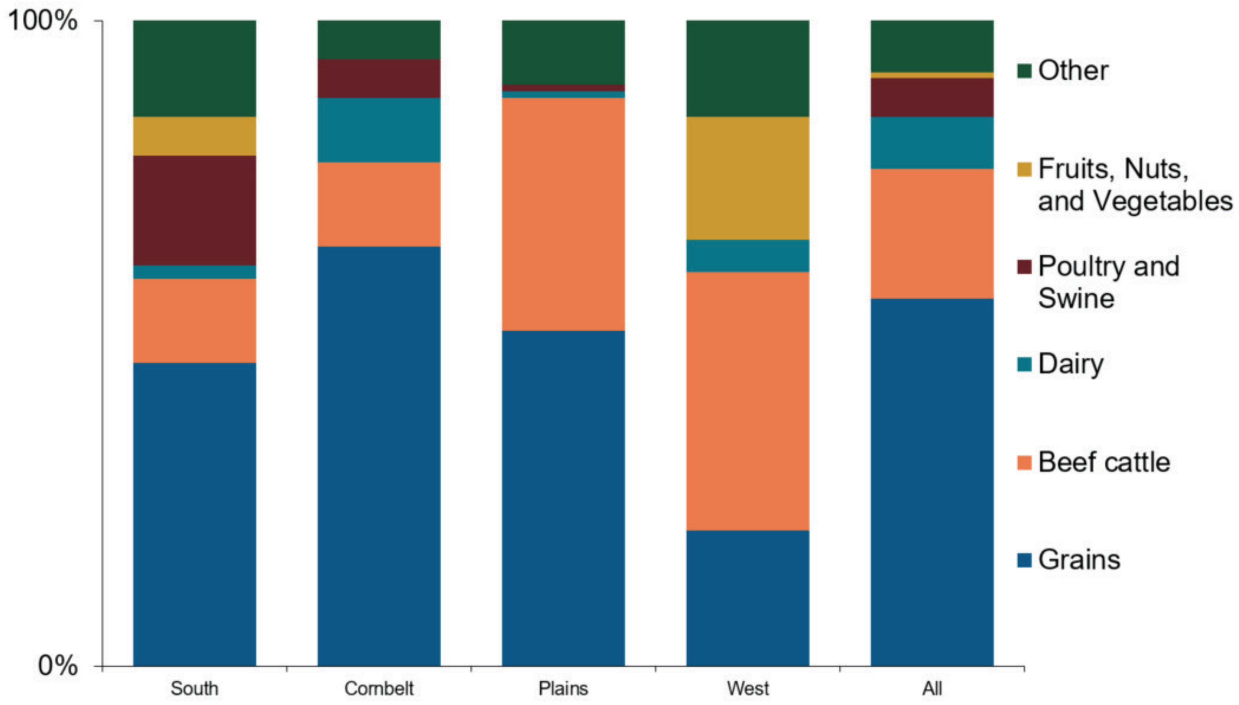
Of the thousands of agricultural lenders contacted, more than 580 completed the second ABA-Farmer Mac Agricultural Lender Survey in June. The responses came from a diverse set of institutions ranging from under $50 million in assets to more than $5 billion in assets. Approximately two-thirds of the responses came from lenders at institutions with $500 million or less in assets (65 percent). Regionally, the responses were somewhat concentrated in the Cornbelt states (60 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.

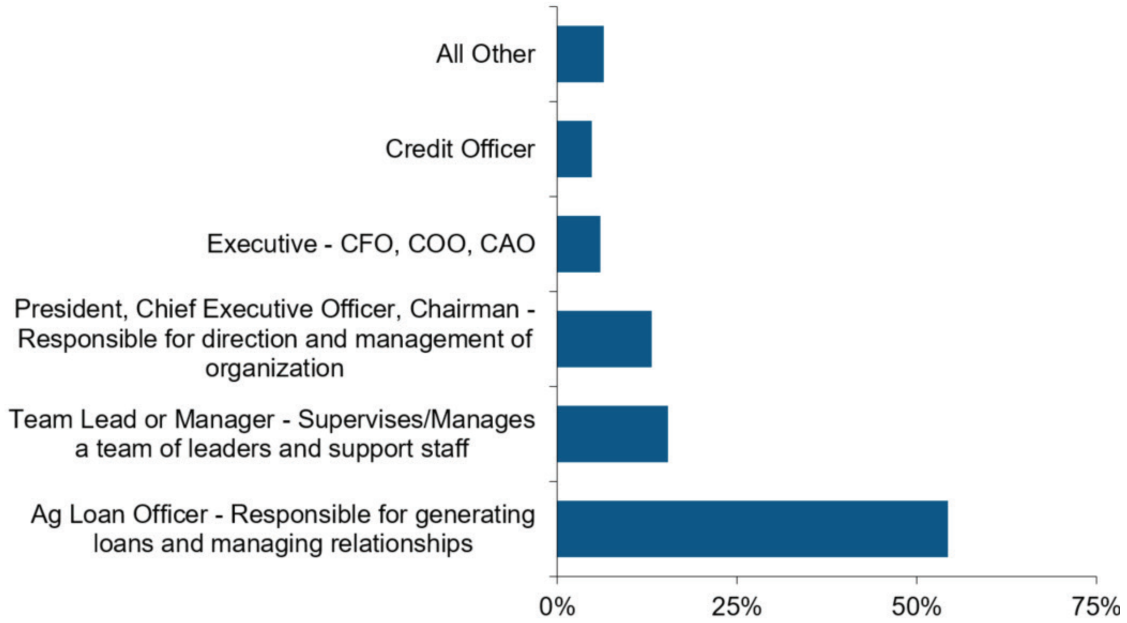
Lender Portfolios Vary by Region



Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
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 (54 percent). Others reported team manager roles, senior executives and credit officers.

Survey Respondent Job Responsibility



Source: ABA-Farmer Mac Agricultural Lenders Survey June 2017.
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 more than $9 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.

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