Mississippi Agricultural Credit and Lending Conditions: 2018

This report is intended to be an informational guide for producers, lenders, and professionals working in the agricultural finance sectors. It is based on a May 2018 survey of agricultural lenders, appraisers, farm managers, and economists.

National and Regional Lending and Credit Conditions

The USDA has reported that farm profits are expected to decline further in 2018. While net farm income is a very broad and often ambiguous metric, the decline does indicate the farm economy continues to sour. The inflation-adjusted decline from 2017 is expected to reach 8.3 percent and would mean the lowest farm income levels since 2002. Lower commodity prices for corn, cotton, and wheat are the primary cause for the income decline; increases in production expenses including interest, fuels, and labor costs have also contributed (**Figure 1**).

The 8th Federal Reserve District (including portions of Missouri, Illinois, Kentucky, Arkansas, Mississippi, and Tennessee) reported in its quarterly survey of lenders that the demand for loans in 2017 remained near 2016 levels, which was approximately 20 percent higher than the baseline index. Meanwhile, the rate of loan repayment had an index of 76–90 percent. This was significantly better than the same time period in 2016.

Farm household spending in the 8th District was also higher through 2017 compared to the previous year but still below the baseline index. However, capital spending remained near 50 percent of the baseline index as tight fiscal management continued through 2017.[1]

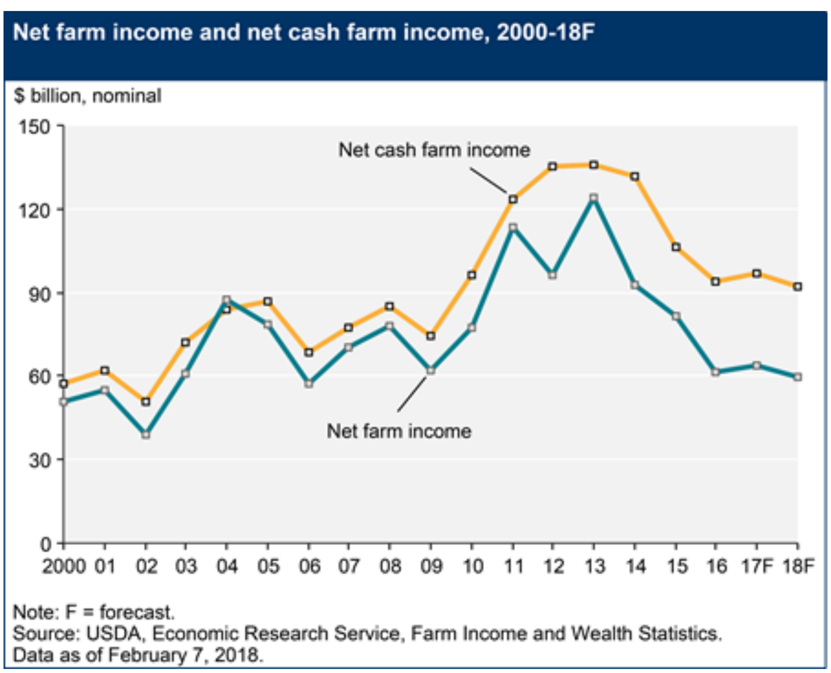

Figure 1. Net farm income 2000–18. Source: USDA-ERS 2018 Farm Sector Forecast Chart. Downloaded from https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farm-income-forecast/

Mississippi Credit and Lending Conditions

Interest Rates

The 8th Federal Reserve District reported regional variable and fixed interest rates for operating, intermediate-term, and long term real-estate loans. **Table 1** compares variable and fixed interest rates obtained from MSU Agricultural Economics and MSU Extension Service surveys to those reported by the 8th District.

Table 1. Average variable and fixed interest rates for Mississippi and the 8th Federal Reserve District.

	Short-term loans	Intermediate-term loans	Long-term loans
	Fixed interest rates (%)		
Mississippi	5.58	5.51	5.06
8th Federal Reserve	5.83	5.81	5.60
	Variable interest rates (%)		
Mississippi	5.06	5.11	5.10
8th Federal Reserve	5.42	5.46	5.08

Statewide interest rates for prime borrowers in Mississippi are lower than the 8th Federal Reserve District for each length of loan. This phenomenon has been a nearly constant feature of this annual survey since its inception, indicating that interest rates in Mississippi are lower than those in the more northern states including Missouri, western Illinois, and

Tennessee. Mississippi's variable rates are also lower with the exception of variable rates for real-estate loans. 8th Federal Reserve District real-estate or long-term variable rate loans are nearly the same as Mississippi's, while both short- and intermediate-term loans are nearly 35 points lower than those originating in Mississippi.

Interest rates across Mississippi are up sharply for short-term operating loans and intermediate-term equipment loans from 2017, when the survey found them to be 4.7 percent and 4.85 percent, respectively. The 2018 survey has both loan types hovering around 5.5 percent for prime borrowers, which is approximately a 0.75 percent increase from a year ago. However, real-estate loans are being made at a rate similar to what was being offered in 2017. Variable rate loans are up nearly 0.5 percent from 2017 into 2018 for all three loan types.

Mississippi Lending Conditions

Loan-to-value (LTV) rates are the principal percentage of new purchases lenders are willing to finance. The higher the percentage, the more risk the lender is taking on. High LTVs indicate lender optimism regarding repayment or asset appreciation.

Table 2 shows LTV rates for three typical Mississippi term loans. Average LTV rates were 71 percent for agricultural land or real-estate loans, 65 percent for medium-term machinery-type loans, and 62 percent for cattle and livestock loans.

Table 2. Loan-to-value ratios for selected 2018 agricultural loans.

	Average	Minimum	Maximum
Land/real estate	71%	55%	85%
Machinery/medium length	65%	55%	80%
Cattle/livestock	62%	50%	75%

The LTV rates for 2018 loans are down from the rates surveyed a year ago for equipment loans and new livestock purchases, but close to what was being offered for new land purchases in 2017 (**Table 3**). The drop in LTV for real-estate loans is too small to be considered statistically different from 2017 into 2018. An 8 percent drop in LTV for equipment loans indicates that lenders are less confident in farm equipment holding its value, while the 5 percent drop in new cattle purchase LTVs shows that lenders are leery of fluctuations in the cattle market.

Table 3. Loan-to-value ratios for selected 2018 versus 2017 agricultural loans.

	2018	2017	Spread
Land/real estate	71%	74%	-3%
Machinery/medium length	65%	73%	-8%
Cattle/livestock	62%	67%	-5%

Operating Capital and Financial Stress

Further evidence of lender-perceived weakness in the equipment market is the loan-to-book value lenders are willing to loan on currently held farm equipment. The average response was that lenders are only willing to use up to 55 percent of a piece of equipment's book value as equity on any loan. This gives lenders a 45 percent cushion (100 percent of book value minus 55 percent loan value) in the case of a default.

The MSU Extension survey asked lenders the percentage of borrowers who have:

- less than 1 year's operating capital,
- 1–2 years' operating capital,
- 2–3 years' operating capital, and
- more than 3 years' operating capital.

Lenders across Mississippi stated that, on average, 64 percent of farmers have less than 1 year's operating capital available to meet financial obligations, and 36 percent have 1–2 years' operating capital. One survey respondent indicated that his/her client had more than 2 years of operating capital available.

The 2018 MSU Extension survey requested the percentage of 2017 distressed agricultural loans (operating loans requiring a significant portion to be carried over into 2018) as well as the change in the number of distressed agricultural loans since 2017. Nearly 50 percent of respondents reported that the number of distressed loans decreased from 2017 into 2018, while nearly 20 percent indicated that they had seen an increase in the number of distressed loans. Approximately 30 percent of respondents stated that they saw no change in the quantity of distressed loans from 2017 into 2018.

Respondents reporting fewer or no real difference in distressed accounts supports the lower amount of loan carryover from 2017 into 2018. The 2018 survey reports an average carryover of 14.65 percent; this is down from 18 percent in 2017 and 21 percent in 2016. This carryover does not necessarily indicate an improvement in farm wealth or revenue generation because loan carryover reduction can be a result of selling land/assets or off-farm income being used to retire outstanding operating notes.

Summary and Outlook

In September, the Federal Reserve announced an increase in the federal funds rate from 2 to 2.25 percent. They have indicated that there will be at least one more rate hike in December 2018 to 2.5 percent, and perhaps as many as three more rate hikes in 2019. At present, the 10-year U.S. Treasury bond (T-bill) yields have increased to around 3 percent in 2018 and continue to inch higher. Though there may be a lagged response between the change in T-bills and long-term mortgage rates, they are both highly correlated, as T-bills are a good barometer for the direction mortgage rates are moving (**Figure 2**).

The implications of the Federal Reserve rate hikes for farmers include higher borrowing costs and potentially lower asset values at a time that U.S. and Southern agriculture can least afford it. It is well documented that interest rates have been held historically low. These low interest rates make borrowing inexpensive and help to spur investment in farming operations as well as to finance losses from challenging years. However, higher interest rates will increase borrowing costs for those needing loans and may push those nearing insolvency over the edge.

Higher interest rates impact asset values because they translate to higher loan payments. If the burden of the interest rate is too high, then the only recourse is to decrease the principal value of the purchase to hold the payment down. Those who are finding higher borrowing costs difficult to deal with may get hit again with a lower valuation of their primary asset—farmland.

In historical context, a 3 percent 10-year T-bill return is still relatively low. As recently as 2010, T-bill yields were near 4 percent; in 2007, T-bill yields were over 5 percent. For most of the 1990s T-bill yields fluctuated between 5 and 7.5 percent and were considered relatively low compared to the early 1980s when T-bill yields reached 15 percent.

This is not an attempt to minimize what the current rate hikes mean for agriculture; it is, however, emphasizing that agricultural producers across the country and the Midsouth have been counting on historically low rates that are highly likely to revert back to some historical average at some point in the foreseeable future.

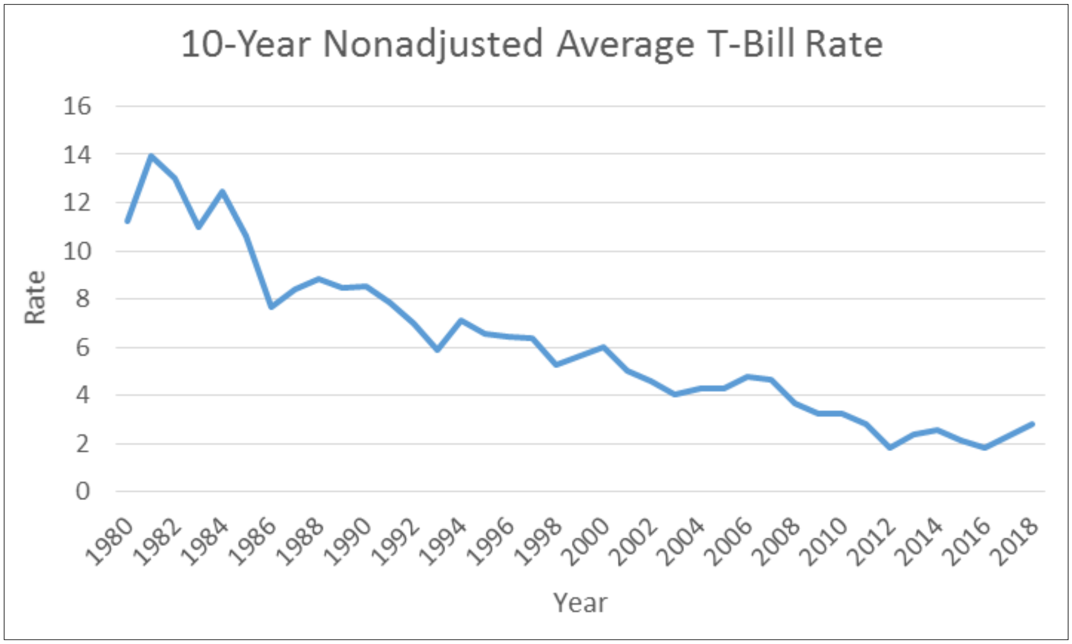

Figure 2. Non-seasonally adjusted rate on 10-year treasury bills. Source: St. Louis Federal Reserve Economic Data. Downloaded from: https://fred.stlouisfed.org

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