Mississippi Credit and Lending Conditions: *2016*

This report is intended to be an informational guide for producers, lenders, and professionals working in the agricultural finance sectors. The report is based on a survey conducted in May 2016 (IRB# 15-156) by the MSU Department of Agricultural Economics and the MSU Extension Service. The participants in the survey included agricultural lenders, appraisers, farm managers, and agricultural economists.

National and Regional Lending and Credit Conditions

2016 farm incomes are expected to be down from 2015 across the U.S. as farm incomes continue their free-fall from 2013's record high. The USDA expects direct farm program payments to increase by $3.3 billion nationally, which would be a 31.4 percent increase from a year ago[1]. 2016 farm incomes have been helped to some extent by a modest 2-year (2015–16) decline in crop production costs, as well as a spring rally for corn, soybeans, and other commodities. However, there are still many high-cost farmers hampered by high cash rents and equipment payments who will fail to break even without a major price rally (**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 demand for loans was up, while the rate of loan repayment had fallen. The 8th District reports that 9 percent of first-quarter loans in 2016 had major or severe repayment problems, resulting in potential forced sales or long-term workouts. A total of 14 percent of current loans had minor repayment problems, with 78 percent having no repayment problems moving into spring of 2016. The 8th District also noted that 34 percent of clients have borrowed up to their limit, prompting major reductions in household spending and capital spending across the 8th District[2].

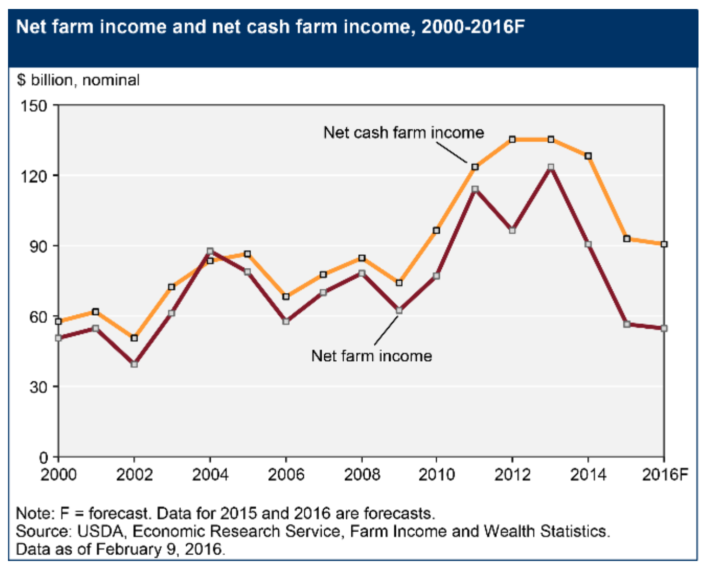

Figure 1. Net farm income 2000–16.[3]

[1]USDA ERS. 2016 Farm Sector Income Forecast. "Ag Sector Weakness Forecast to Continue Into 2016." Retrieved on 6/8/2016. http://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/2016-farm-sector-income-forecast.aspx

[2]Agricultural Finance Monitor. The St. Louis Federal Reserve. 2016 First Quarter.

[3]USDA-ERS 2016 Farm Sector Forecast Chart. Downloaded from: http://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/2016-farm-sector-income-forecast.aspx

Mississippi Credit and Lending Conditions

Interest Rates

Regionally, the 8th Federal Reserve District reported variable and fixed interest rates for operating, intermediate-term, and long-term real estate loans. **Table 1** shows variable and fixed interest rates from MSU Department of Agricultural Economics and MSU Extension Service surveys compared to those in 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	4.6%	4.72%	4.61%
8th Federal Reserve	5.42%	5.68%	4.10%
	Variable Interest Rates		
Mississippi	4.37%	4.37%	4.37%
8th Federal Reserve	5.30%	4.54%	4.97%

Statewide interest rates for prime borrowers in Mississippi are lower than the 8th Federal Reserve District for each length of loan. Mississippi's variable rates are also lower, indicating that borrowing in the state is cheaper than in the district as a whole.

For the most part, fixed interest rates for Mississippi borrowers remain unchanged from a year ago. Short-term and intermediate-term loan rates are identical to the 2015 survey, and long-term fixed rates are actually down 0.4 percent in 2016. However, in the fall of 2015, the U.S. Federal Reserve increased interest rates 0.25 percent and has indicated there will be further increases at some point. As a result, variable interest rates are up 0.25 percent in 2016 from the same time a year ago, as variable rates are often pegged to the federal funds rate.

The MSU Extension survey asked lenders their expectations for the movement of interest rates in the next 12 months. Sixty-six percent of respondents expect interest rates to increase in the next year, while 34 percent of respondents expect no change in interest rates across Mississippi.

Mississippi Lending Conditions

The loan-to-value (LTV) rate is the 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 75 percent for agricultural land or real estate loans, 73.8 percent for medium-term machinery type loans, and 63.5 percent for cattle and livestock loans.

Table 2. Loan-to-value ratios for selected 2016 agricultural loans.

	Avg.	Min.	Max.
Land/Real Estate	75%	62%	85%
Machinery/Medium Length	73.8%	50%	90%
Cattle/Livestock	63.5%	50%	90%

The LTV rates for 2016 loans are down from the rates surveyed a year ago. 2015 LTV rates for land, machinery, and cattle averaged 78 percent, 75.6 percent, and 66.8 percent, respectively, in 2015 (**Table 3**). The drop, albeit small, in LTV rates this year indicates both a worsening in farmer credit-worthiness and repayment capacity from a year ago, and pessimism among lenders regarding the future of agricultural asset values.

Table 3. Loan-to-value ratios for selected 2016 vs. 2015 agricultural loans.

	2016	2015	Spread
Land/Real Estate	75%	78%	-3%
Machinery/Medium Length	73.8%	75.6%	-1.8%
Cattle/Livestock	63.5%	66.8%	-3.2%

Operating Capital and Financial Stress

Weakness in the value of farm equipment has affected lenders' willingness to collateralize debt with farm equipment. Some survey respondents report their institutions allowed 80 percent of farm equipment book value to be used in new loans, while the majority of intuitions are allowing between 40 and 75 percent to be used. On average, lenders are allowing 62.7 percent of the book value of farm equipment to be used as collateral on any new loans.

High farmland values and cash purchases for agricultural assets have resulted in favorable debt-to-asset ratios for farmers over the last decade. However, equity in the form of land or machinery is less liquid, so farmers must either borrow against said assets—or sell—to meet future repayment obligations when costs exceed revenues.

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'. Lenders across Mississippi stated that, on average, 61 percent of farmers have less than 1 year's operating capital available to meet financial obligations, and 39 percent had 1–2 years' operating capital. No responding lenders stated that clients had more than 2 years' operating capital available.

The 2016 MSU Extension survey also requested the percentage of 2015 operating loans requiring a significant portion to be carried over into 2016, as well as the change in the number of distressed agricultural loans compared to 2015. Respondents reported a range of 2015–16 loan carryover from 5 percent to 50 percent. The overall average rate of carryover across the state was nearly 21 percent. Also, a full 87 percent of lenders expect the number of distressed loans to increase from 2016 to 2017, as 76 percent of lenders expect Mississippi farm incomes to fall once again over the next 12 months.

Summary and Outlook

2014 and 2015 were challenging years for producers and their partners in the agricultural lending sector. The precipitous fall in commodity prices left producers facing high costs without the revenue to cover them. While production costs have come down some moving into 2016, and a spring rally in corn and soybeans has helped soften the blow, many producers are still looking at a market where their projected revenue is below breakeven.

Indeed, the decade leading up to 2014 was generally favorable for producers. Many farmers favored expansion over paying down debt or creating an operating capital cushion for inevitable tough times ahead. Also, much of the newly purchased assets were paid for in large part with cash. However, with no cash reserves, lenders must count on producers being able to borrow against said assets, or sell to meet debt-payment obligations. Moreover, recent land expansions purchased at peak prices increase exposure during times of poor commodity markets and high costs. Increased exposure means that large, high-cost farms will hemorrhage money faster than their smaller counterparts if net revenues are negative.

With more than 20 percent of Mississippi farmers carrying 2015 operating debt into 2016, and most producers having less than 1 year of operating capital available, the carried-over debt will need to be collateralized either by owner equity or sold assets. Producers with low debt-to-equity ratios should provide lenders with some much-needed flexibility moving forward. However, the only option for highly leveraged producers is forced sales, which will reduce asset values across the board and begin putting less-highly leveraged clients in jeopardy.

Historically low interest rates over the last few years have also helped soften the blow of needing to increase producer term debt during this period of negative margins. Recent comments from the U.S. Federal Reserve indicate a very gradual increase in interest rates over the next few years. A gradual increase is positive news for lenders and producers during difficult financial times. A sudden jump would be devastating because it would make borrowing much more expensive. It would also drop land values, reducing producer credit flexibility.

The next 12 months will be a challenging time for agricultural lenders and producers. Many farmers in precarious financial situations may soon face forced sales, and a depressed equipment market certainly won't improve matters. However, most producers are still in favorable debt-equity positions, and interest rates are low enough that new loans are relatively cheap. It still doesn't look like a 1980s-magnitude correction is going to happen, but if agricultural financial conditions worsen, things could start moving in that direction.

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