PolicyPennings by Dr. Daryll E. Ray

Have land prices peaked?

A thoughtful letter from a reader got me thinking about land prices. Given the number of issues that face agriculture, have farmland prices peaked? While it is impossible to answer that question with any degree of certainty, one can identify a number of factors that have the potential to put downward pressure on land prices.

At or near the top of the list is the recent U.S. General Accounting Office (GAO) report, "Farm Program Payments: USDA Needs to Strengthen Regulations and Oversight to Better Ensure Recipients Do Not Circumvent Payment Limitations." In a summary, the report says, "Individuals may circumvent the farm payment limitations because of weaknesses in FSA's [Farm Service Agency's] regulations." The report went on to say, "We found examples of farming operations where recipients may circumvent the payment limits by organizing farming operations to maximize program payments and then channeling the payments to affiliated nonfarming operations. . ."

As a result of this report and pressure from legislative leaders, it now seems certain that congress will adopt more restrictive payment limitations. If the advocates of these measures are correct, revised payment limitations, especially if the levels are lowered, will reduce the amount of money larger operators have available to bid up cash rents and the price of farmland.

Next on the list of factors that have the potential to put downward pressure on farmland prices is the recent WTO ruling in the Brazil-U.S. cotton case. The ruling went against the U.S. declaring that U.S. subsidy levels were not in compliance with international agreements. While the ruling was limited to cotton, the principles involved in the decision could extend its impact to other crops as well. If, to settle the dispute, the U.S. were to drastically reduce farm payments, U.S. net farm income could plummet. Farmland prices would head south and fast.

Coupled with the above two factors is the current U.S. federal budget deficit that seems to increase with every bit of news out of Iraq. Even in the absence of the payment limitations controversy and the WTO legal action, the deficit alone has the potential to put pressure on current farm program payment levels. While the Defense Department and Social Security may be spared any cutbacks, the USDA certainly would be affected by any action aimed at reducing the deficit by making across-the-board cuts in all remaining program areas. Again, lower farm payments could put pressure on both cash rents and land prices.

The recent surge in oil and natural gas prices will drive up input costs for most farmers, reducing profit levels and the attractiveness of higher priced land. Likewise, as interest rates rise, the profitably of purchasing additional farmland will decline. Also, the financial obligation of those with variable rate loans will increase. These factors could be mitigated if current crop and cattle prices become the norm. But that, of course, is unlikely.

In each case, the price of land and cash rents are where economic readjustments will take place. Cash renters will benefit from lower cash rents but lower and more variable crop prices are likely to wash away that benefit.

Currently, the cushion of government payments and the expectation of continued support have a stabilizing and, yes, a bolstering impact on land prices. Current market prices have combined with these to put additional upward pressure on farmland prices.

With the policy uncertainties and the inevitable decline in crop prices from current levels, this year or next could mark a short to medium-term peak in farmland prices.

We are not suggesting that we are facing a catastrophe like we saw in the mid-1980s. But, what we do see are a number of factors that could come together to contribute to a downward trend in farmland prices in the foreseeable future. The exact impact will depend upon public policy measures that are put in place in response to these factors.

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Originally published in *MidAmerica Farmer Grower*, Vol. 21, No. 26, June 25, 2004

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