

Policy Pennings by Daryll E. Ray & Harwood D. Schaffer

Land prices are up, up, but let's hope not away-like a bubble

For most of us of a certain age, the experience of the agricultural sector in the 1980s is seared into our minds. The average value of all US farmland had relentlessly increased from \$82 an acre in 1954 to \$823 per acre in 1982—the best land was selling in the vicinity of \$3,000 per acre. Beginning with the explosion of the export markets in the early 1970s, US farmland prices increased at double-digit rates from 1973 to 1981.

Several factors played into this increase in land prices. Crop prices tripled between 1971 and 1974, inflation soared, and the idea that "they aren't making any more Iowas" became a dominant theme. Crop exports peaked about a year before average US land prices peaked.

At the same time, though some farmers were experiencing a negative cash flow when prices softened, financial institutions were willing to continue to lend them money because their net worth was increasing year by year. And that worked as long as land prices were going up.

We thought about this history this week when we read a copy of the February 2011 issue of "The Agricultural Newsletter from the Federal Reserve Bank of Chicago," http://www.chicagofed.org/digital_assets/publications/agletter/2010_2014/february_2011.pdf.

In the newsletter, the Chicago Fed announced that, "the annual growth in agricultural land values was 12 percent in 2010 for the Seventh Federal Reserve District—the second-largest increase in the past 30 years. There was a 6 percent rise in the value of "good" farmland in the fourth quarter relative to the third quarter of 2010, based on 212 surveys returned by agricultural bankers from around the District. Slightly more than half of the respondents expected farmland values to keep rising during the January through March period of 2011."

They also noted, "although the annual index of nominal farmland values set a new high, the index of inflation-adjusted farmland values remained a shade below the peak of 1979.... In contrast with the prior peak, economic conditions reflected historically low interest rates and inflation rates, dampening the returns on traditional savings vehicles (such as certificates of deposit). Thus, farmers sought to maximize the returns on their funds by plowing money into farmland purchases and expanding their operations to enhance future earn-

ings. Since farmland values bottomed in 1986, the compound annual growth rate for farmland values (adjusted for inflation) has been 4 percent."

As a reflection of credit conditions, the agricultural bankers responding to the survey reported that "non-real-estate farm loan repayment rates accelerated in the fourth quarter of 2010 compared with the same quarter of the prior year. The index of repayment rates was 142 in the final quarter of 2010, with 47 percent of respondents noting higher rates of loan repayment and just 5 percent noting lower rates. This was the highest value for the index since early in 2008."

New York Times reporter William Neuman, in reporting on the Federal Reserve Bank of Chicago newsletter, wrote about 80 acres of Le Mars, Iowa farmland that sold for \$10,000 an acre." In explaining the prices, Neuman explained, "Just a few years ago, farmers marveled as land prices began to rise in response to demand for corn to make ethanol. More recently, soaring prices for wheat, corn, soybeans and other crops have driven the increase. Corn futures on the Chicago Board of Trade closed at \$7.27 a bushel on Tuesday [March 1, 2011], up from \$3.70 a year earlier. Soybean futures were \$13.67, up from \$9.52 cents on March 1 [2010]. Average grain prices, adjusted for inflation, are nearing the giddy levels they reached in the late 1970s, the peak of the last disastrous boom-and-bust cycle for agricultural land. That has regulators worried."

It has us worried, too. As in all things financial, timing is everything. Those who bought land near the bottom, likely have little to worry about, while those who buy near the top could be in trouble if crop prices plummet and land prices follow. It is true, that the current interest rates and the loan-to-asset ratio are favorable, leaving farmers in a different situation than they faced in the 1980s. That being said, much of that asset value is in land and if land prices drop, the loan-to-asset ratio deteriorates quickly.

In both periods, as prices climbed to very high levels so did input costs. In our discussion with farmers, it would not take much of a fall-off in prices, to put their balance sheets in the red. And it is hard to pay on loans with a negative cash flow.

That brings us to some discussions we have had

Cont. on p. 2

Originally published in *MidAmerica Farmer Grower*, Vol. 31, No. 10, March 11, 2011
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Cont. from p. 1

recently. About a month ago we were talking to several leaders of an NGO (non-governmental organization) involved in farm issues and they asked us about farm foreclosures. They said they were hearing stories of farmers going into foreclosure because either the farmer or the spouse had lost their job in the current recession. Without the off-farm income, they were drawing their household living expenses from the farm, leaving no money to service the farm loans.

At a recent farm meeting, one of the speakers had to cancel because he was due in court. He was

representing two very large farmers in bankruptcy proceedings.

An auctioneer quoted in the New York Times article said that with prices rising so quickly, "it's getting scary." We agree.

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