

# Farmland

## IN PERSPECTIVE

Volume 26, No. 2



### North America Moves Toward One Market

The agricultural economies of Canada, Mexico and the United States are increasingly behaving as if they form one market. Not only is U.S. agricultural trade with Canada and Mexico on a clear upward trend, but firms are reorganizing their activities around continental markets for both inputs and outputs. For example, many North American pastures and feedlots contain animals that have lived in more than one NAFTA country, and U.S. consumers are purchasing fresh tomatoes and peppers produced by their neighbors both to the south and to the north.

Trade liberalization under the Canada-U.S. Free Trade Agreement (CFTA, implemented in 1989) and the North American Free Trade Agreement (NAFTA, implemented in 1994) is just one factor behind the growing integration of North American agriculture.

The past 11 years (1994-2004) have seen a rapid integration of North American grain markets. Since NAFTA's implementation in 1994, U.S. exports to Mexico, Canadian exports to the United States, and U.S. exports to Canada have all more than doubled.

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### For Farmland Investments, Knowledge is The Key

By Dr. Gary Schnitkey

Whether or not farmland prices will decline in the near future is unanswerable. As farmland prices have increased dramatically during the past several years, some individuals are asking if now is a good time to sell. The thought is that farmland may have reached its peak and may begin to decline.

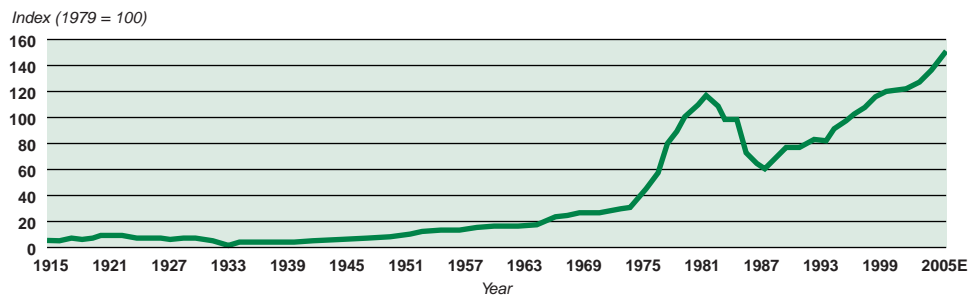
Some factors suggest prices will moderate while other factors suggest that farmland prices will continue to increase. The decision to sell farmland should be based on several factors, including prospects for farmland price increases, returns from investment alternatives, and desire for liquidity.

Once the decision to sell has been made, using a knowledgeable person to aid in the sale is advisable. A great deal of difference in farmland prices usually exists within a local area, suggesting that knowledge is a key for obtaining high farmland prices.

#### Farmland Prices

Similar trends and increases exist across much of the Midwest and Great Plains. In Illinois, for example, farmland prices have been increasing since 1988 (Figure 1) with fairly substantial increases in the last several years and record-setting increases in 2004. The Illinois Society of Professional Farm Managers and Rural Appraisers reported average increases across Illinois in excess of 10% per year, with many geographical areas having increases between 15 and 20%.

Figure 1: Illinois Land Value Index, Nominal, 1912 – 2005P



Source: U.S. Department of Agriculture. The 2005 value was estimated by Gary Schnitkey.

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**Farmland investments** cont. from page 1

The same holds true elsewhere. The Federal Reserve Bank (Fed) of Dallas reported 2004 price increases in Texas ranging from about 5% for dryland cropland up to 19% for ranchland. The Kansas City Fed reported that ranchland rose 10.5% and cropland rose more than 8% in Colorado, Kansas, Nebraska, Oklahoma, and Wyoming. The Minneapolis Fed reported an average increase of 15% across Montana, the Dakotas, Minnesota, and western Wisconsin. The Iowa Farm and Land Chapter of the REALTORS Land Institute (RLI) reported an average land value increase in Iowa of 6.5% between March 2004 and March 2005.

Recent increases have caused some people to worry and to ask the following question: Has the land market overheated and will there be a correction? Perhaps land prices will decline similar to the decline in the mid 1980s (see Figure 1).

**Factors Impacting Land Prices**

In my estimation, farmland prices are not likely to decline as they did in the 1980s. The land market in 2005 is fundamentally different in two

ways than the land market during the 1980s.

First, in real terms, land prices are not as high in 2005 as they were in the early 1980s. The index numbers in Figure 1 represent nominal land prices and do not consider inflation's devaluing impact on the dollar. The nominal price indices in Figure 1 are stated in real terms using the Gross National Product – Implicit Price Deflator. The resulting, real indices are shown in Figure 2.

What stands out in Figure 2 is the large increase during the early 1980s, followed by the decline in the mid 1980s. If this boom and bust period were taken out, the remainder of the graph would suggest prices that have increased at a relatively stable rate across time. When viewed in real terms, the recent farmland price increases, while large, are not as out of line as occurred during the early 1980s.

Second, the farmland market is being driven by fundamentally different factors now than during the 1980s. In a recent survey, members of the Illinois Society of Professional Farm Managers and Rural Appraisers were asked to identify factors causing farmland price increases. The three

largest factors were the large number of 1031 exchange buyers (7.1 score out of 10), limited supply of farmland (5.3), and low interest rates (3.0). Factors related to farmland returns, such as high corn and soybean yields (1.0 score) and government support programs (.5), received very low scores.

What can be inferred from this survey is that commercial and residential development is the main driving factor causing farmland price increases. As land is developed, the owners of the developed land often desire to replace the land to be developed with farmland in another location. Competition among these "1031 exchange" buyers, along with demand from local individuals, has pushed farmland prices higher.

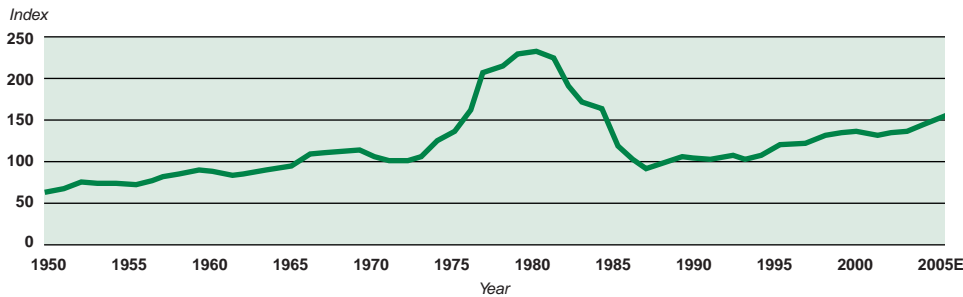
**Local Markets**

Given that development is causing increases, farmland prices are not likely to decline until development demands dampen. At this point, demand does not appear to be decreasing. The U.S. Department of Commerce reported that housing starts in April 2005 were about the same as 2004 levels. Interest rates, while increasing somewhat, are still at historically low levels.

However, it is not likely that farmland prices will continue to increase at 2004 rates continually into the future. Eventually, we can assume that farmland prices must come into line with what farmland can earn and earnings from farmland are not expected to appreciate in the near future. Hence, for some individuals, now may be a good time to consider selling farmland.

When selling farmland, the use of a knowledgeable real estate professional is important. This farmland

**Figure 2: Illinois Land Value Index, Real, 1950 – 2005E**

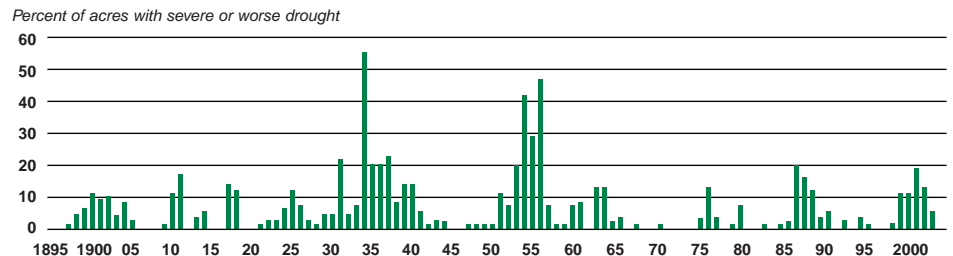


Source: Data in Figure 1 and Gross Domestic Product – Implicit Price Deflator.

**Drought: A Recurring Risk**

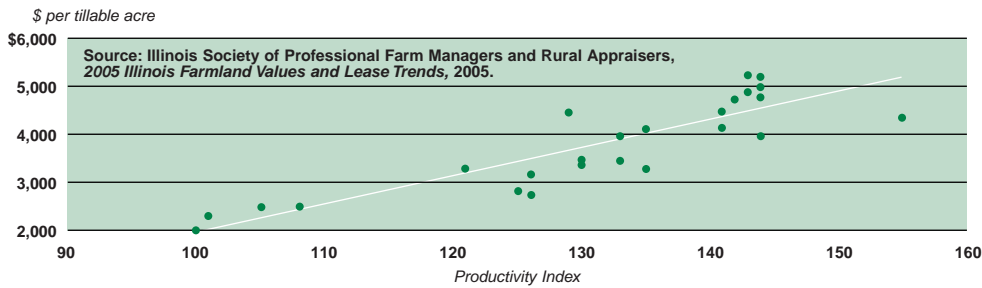
During the past century, an average of 7 percent of U.S. agricultural land has experienced severe or extreme drought each year. More than half the total agricultural land experienced severe or extreme drought in 1934, and more than 40 percent in 1954 and 1956. More recently, in 1988 and 2002, approximately 20 percent of acreage was affected. In 2004, about 56 percent of the agricultural land experienced severe, extreme, or exceptional drought.

**Severe and extreme drought on agricultural land, 1895-2004**



Note: Percentage of land is based on current land use for agriculture, including land in crops, pasture, range, and USDA's Conservation Reserve Program.  
Source: National Oceanic and Atmospheric Administration.

**Figure 3: Sales Price for Individual Tracts in Eastern Illinois, 2004**



professional will assist with the details associated with listing, advertising, and selling the property. More importantly, he or she will be able to perform a complete market analysis for a perspective seller and know who is in the market for farmland.

Considerable variations exist in the prices received for farmland tracts. As an example of this, *Figure 3* shows per acre sale prices of farmland in eastern Illinois as reported by the Illinois Society of Professional Farm Managers and Rural Appraisers. Each dot shows a tract sale occurring in 2004, with the price indicated in the horizontal axis and the soil productivity index (PI) indicated on the vertical axis. The PI indicates the yield potential of the farmland, with higher PIs indicating higher yield potential. The solid line indicates the trend in price as PI increases.

Note that prices generally increase as productivity increases (*Figure 3*), but a considerable variation in prices exists for a small range of PIs. For PIs from 140 to 150, for example, prices range from \$4,000 to \$5,261 per acre, a difference of \$1,261.

A real estate professional knows the price range that exists in a market. More importantly, they can assist their sellers in getting prices near the top of that range.

### Summary

Some individuals may want to take advantage of recent price increases and sell farmland. In doing so, they can capture higher prices and use the proceeds to invest in other, more liquid investments.

This suggestion, however, does not indicate that farmland is not a good investment. Over time, the risk-adjusted returns to farmland have been comparable or superior to other investments. While price increases cannot continue indefinitely at 2004 rates, a price decline like the 1980s does not currently appear to be in the offering.



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### North America Moves Toward One Market *cont. from page 1*

While NAFTA provides much of the legal framework for this growing trade and has facilitated the development of cross-border supply chains, the primary catalyst for this trade has been a dramatic expansion of Mexico's hog and poultry industries, driven in turn by a rising demand for meat in that country. These industries in their drive to expand output and lower production costs rely heavily on U.S. feedstuffs.

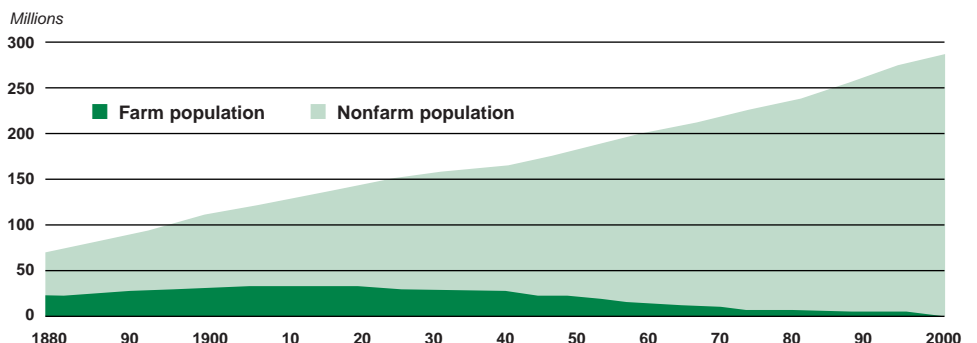
### The agricultural economies of Canada, Mexico and the United states are increasingly behaving as if they form one market.

In the coming decade, Mexico's grain market is likely to experience further integration with the United States. NAFTA allows Mexico to apply a transitional tariff-rate quota to U.S. corn until 2008. In fact, Mexico has pursued a more liberal trade policy than NAFTA requires, particularly with respect to yellow corn, so that the country can benefit more fully from the integrated grain market.

## Farm population as a share of total U.S. population

Farm population has fallen steadily as a share of total U.S. population for more than a century. Less than half the U.S. population has lived on farms since these data were first collected.

### Farm population has decreased steadily



Source: Prepared by ERS using the Census of Agriculture.

# Farmland IN PERSPECTIVE

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## LAND REALTOR® OF AMERICA

**Winnie Stortzum, ALC, GRI, ARA, REALTOR® and appraiser at Boyd Real Estate, Inc. of Arcola was recently honored as the 2004 Land REALTOR® of America by the REALTORS® Land Institute (RLI).** Stortzum was selected from a field of 1,500+ members of RLI – all farm and land brokers in the United States, Canada and Mexico.

**Winnie Stortzum**  
ARA, ALC, GRI

This prestigious award recognizes dedicated service as a REALTOR® and land broker, participation in community activities and related business activities, and high ethical standards. RLI, an affiliate group of the National Association of REALTORS®, is a national organization of real estate professionals specializing in all aspects of land sales – farms and ranches, commercial properties, vacant and recreational acreage and investment properties.

Stortzum has been selling and appraising farmland at Boyd Real Estate, Inc. in central Illinois since 1981. She has previously been recognized as the 1994 Illinois Farm and Land Broker of the Year; the 1992 Associate-REALTOR® of the Year from 35,000+ members of the Illinois Association of REALTORS®; and the 1991 REALTOR® of the Year by the East Central Illinois Board of REALTORS®.

Stortzum has a B.S. in Education with Honors from Eastern Illinois University and a M.A. in Teaching from the University of Illinois. She holds an Accredited Land Consultant (ALC) designation with RLI; a Graduate, REALTOR® Institute (GRI) designation with the National Association of REALTORS®; and an Accredited Rural Appraiser (ARA) designation with the American Society of Farm Managers and Rural Appraisers. She is also an Illinois Certified General Appraiser.

With her specialization in farm real estate sales, rural appraisals, and consulting, Winnie Stortzum can be an invaluable resource for you. Please give her a call or return the postage-paid card for further information or help with any questions you may have. *Thank You!*



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