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Land prices leave farmers in a lurch

By Sue Kirchhoff, USA TODAY

SUTHERLAND, Neb. — Farmland prices in this state have soared more than 50% since 2003, causing both rejoicing and unease for growers such as Roric Paulman, who've lived through boom and bust before.

"Do you want to be euphoric, or do you want to be real?" says Paulman, 49, who has decided to enter far more conservative land values into the computer spreadsheets he uses when figuring budgets and long-term business strategy.

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"I want to know if, six months from now, things drop 20% to 30%, we don't have to worry," adds Paulman, a burly 6-foot-3 farmer who has spent two decades building a rolling corn, wheat, dry bean and soybean operation in west-central Nebraska. He literally started with nothing: His family's farm was auctioned in the 1980s when the rural economy — and high land prices — melted down.

In the biggest sustained gains since the 1980s downturn, farm real estate values more than doubled to a record from 1996 to 2006, rising 40% from 2004 to 2006 alone, the U.S. Agriculture Department says. The increases were propelled by good crop markets, a rash of outside investors, favorable interest rates and tax incentives and a strong housing market. Even as the housing market falters, land values in some areas are rising due to a surge in corn prices and corn-based ethanol production that is creating a gold-rush mentality in parts of the Midwest.

Unlike the 1970s and 1980s, when booming export markets induced farmers to borrow at double-digit interest rates to purchase land, many buyers today are paying cash. Farming and ranching operations have become far more productive — Paulman needs just two full-time employees today to work 7,000 acres. Several years of good prices have helped farmers pay off debt. Still, some bankers and economists, who just a year ago were sanguine about land prices, are becoming uneasy.

Farm income is predicted to remain strong for the next several years, based on forecasts showing corn prices staying near record highs. But income is also likely to be more volatile, as the ethanol market affects prices not only for corn but also for cattle and other commodities. Further, prices will respond to energy markets, weather shocks, and demand for food and feed. Production costs, including rent and fuel, are surging. And Congress is poised to write a new farm bill that could affect subsidy payments to many farmers.

"We've been hearing some concerns from bankers about the elevated (land) prices," says Jason Henderson, Omaha Branch

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executive of the Kansas City Federal Reserve Bank. "Older and more experienced bankers say it's important for them to convey what happened in the 1980s to younger bankers."

After jumping in response to a strong export market and high commodity prices, rural land values fell more than 25% from 1982 through 1987.

Land's 'a bit like gold'

The Midwest is seeing some of the largest land price increases in recent months, but in the past several years the trend has been pronounced in other areas.

Rural real estate prices in Nevada and Montana — a measure that includes farm- and ranchland and buildings — rose about 50% from 2005-2006, and were up more than 35% in Florida, the USDA says.

In Bozeman, Mont., David Johnson, a real estate broker for rural real estate marketing and management firm Hall and Hall, says out-of-state buyers have been snapping up land for scenic and recreational value. Residential land prices have also doubled or tripled.

"The buyers for the ranches are people buying as a second home," Johnson says. "We're driven by luxury, recreation, fishing and access to the national parks."

So much outside money is sloshing around that remote spreads in parts of eastern Montana — where even the early homesteaders couldn't make a go of it — now sell for millions of dollars.

"Land has appeal because it's tangible, it's a bit like gold in that regard: No matter what happens with the Dow, the land is there," says Jerry Warner, executive vice president of Farmers National in Omaha, the nation's largest employee-owned land-management and agricultural-services firm.

"There's just a huge amount of cash in this country. ... We clearly are seeing more investors than we've seen for some time. They are then competing against each other, and that makes for an interesting market," Warner says.

One example: Media magnate Ted Turner last month bought more than 26,000 acres of Nebraska ranchland for about \$10 million. Turner, a major landholder in several states, already owns more than 398,000 acres in the Sandhills area of Nebraska and southern South Dakota, according to the *North Platte Bulletin*.

In states such as Florida, California and New Mexico, land prices had been propelled by a booming housing market. With the housing sector now in the doldrums, land appreciation in those states appears to have slowed or even fallen in recent months.

"I have land for sale. Probably in 2005 I would have sold it in a week, and today I can't sell it, but the listers won't come off their selling prices," says Randy Edwards, accredited rural appraiser and president of the California chapter of the American Society of Farm Managers and Rural Appraisers.

Tax provisions help spur gains

Another factor behind land price gains has been the so-called 1031 exchange tax provisions, which allow owners of an income, business or investment property to sell and then replace it with a like-kind property and defer capital gains taxes. That has pushed up prices, as farmers have sold land near urban areas, often to housing developers, and bought land farther out in the country.

Though the number of 1031 transactions has begun to cool as the housing market has slowed, they have not stopped. The tax provisions were used in 43% of land transactions in Illinois last year, down from 56% the previous year and 48% in 2004, says the Illinois Society of Professional Farm Managers and Appraisers. Lenders told the Minneapolis Federal Reserve Bank in a recent publication that 1031 provisions had taken family farmers out of the game in some cases, with land selling for two to three times its production value.

"There have been ranchers displaced from the Mountain states as people buy their ranches for recreation. They turn around and purchase land in Nebraska to continue to ranch," says Jay Wolf, a farmer, rancher and Nebraska Cattlemen president.

"It doesn't seem to me that there's any hesitation. When something comes up, it's still selling, and at record prices," Wolf says.

Ethanol-driven corn rush

Looking ahead, it's hard to overstate the potential impacts of the ethanol industry. Acting in response to government subsidies and mandates to combat global warming and reduce U.S. demand for imported oil, about 20% of U.S. corn production is now dedicated to ethanol. Corn prices more than doubled to nearly \$4 a bushel on futures markets, before falling recently. Corn closed on the Chicago Board of Trade Wednesday up 4½ cents at \$3.27 — still historically high. The price rise has increased the number of farmers buying land to expand.

"It's all driven by corn prices, but is this sustainable?" says University of Nebraska economist Bruce Johnson, speaking of a 14% rise in land values across the state in the 12 months ended in February. "We have to be really cautious here so that we don't fall into chasing appreciation."

Rising prices for corn and other crops are pushing up land prices and having other indirect effects. Getting to Paulman's farm means driving through miles of lush corn fields watered by huge wheel-mounted sprinklers. The thirsty corn crop is straining water supplies. If corn prices stay high, farmers could take more fragile land out of the federal Conservation Reserve Program.

Rising land values make it harder for newcomers to get into agriculture, while increasing costs to farmers and ranchers who lease acreage.

"It used to be a lifestyle. If it's still a lifestyle, you're losing. It's a business," says Tom Metzger, with Hall and Hall in Colorado.

Rents for farmland in Illinois, Indiana, Iowa, Michigan and Wisconsin, adjusted for inflation, recorded the biggest increase since 1981 from the first quarter of 2006 to the same period in 2007, according to the Federal Reserve Bank of Chicago. That's significant, because the USDA says upwards of 40% of agricultural land is owned by absentee landlords, and many farmers and ranchers lease the land they rely on. Some lease agreements are multiyear or were signed before corn prices soared, meaning rental figures may not reflect the full impact of the higher prices.

Cattle ranchers not as happy

Some paying higher rents aren't benefiting from higher crop prices. Nebraska isn't only a major ethanol state, but also a huge cattle-producing center. Ranchers are not as happy as farmers about higher prices. Rents are rising, some growers are converting grazing land to corn production and higher corn prices increase the cost of feeding cattle.

"Last winter some of these cash rents almost doubled, and people were willing to pay it," says Tom Hansen, a rancher and Nebraska state senator, who operates from a red cedar ranch house near North Platte.

Nebraska ranchers and farmers are working together to address the issues, and possibly realize some potential of feeding corn ethanol by-products, such as distillate grains. Still, Hansen worries that what he calls "just blatant optimism" is contorting price fundamentals.

There is a sense of uncertainty beneath the buoyant prices and rush of ethanol plant start-ups here. Federal ethanol economics include a 51-cent-per-gallon tax credit for petroleum firms that blend ethanol, a 54-cent-per-gallon tariff on imported ethanol and tax incentives for smaller firms. States have their own programs.

"The goal was for ethanol ... to create a local market for corn over which farmers had better control than they had historically" with much of their product exported out of state, say Todd Sneller, administrator of the of the Nebraska Ethanol Board, a state agency. "I don't think any of these communities would have been willing to host (ethanol) plants if they thought this was short term."

While futures markets indicate elevated crop prices years into the future, only time will tell whether prices are at a temporary peak or a new plateau. Farmers may not be borrowing at double-digit interest rates as in the '70s, but could be financially exposed if markets turn and prices fall.

"There are very similar risks to what we faced in the late '70s early '80s, but in this case there are other factors driving what's going on," says Chad Hart, agricultural economist at the Center for Agricultural and Rural Development at Iowa State University. "Agriculture is trying to establish a more permanent link to the energy market."

Nebraska's Paulman invested in a start-up ethanol plant several years ago, realized double-digit gains, then sold his shares. He recently bought land he had been farming on a lease basis for years, but did not pay top dollar. He says that even with corn prices near \$4 a bushel, he couldn't make the higher-priced land pay at current prices "in my lifetime" given higher rent, input and other costs.

"Next year I expect it's going to be a little rough. I suspect the suppliers are going to take advantage of this run-up," Paulman says.

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