FARM REAL ESTATE: WHO BUYS AND HOW

By Marvin Duncan

The value of farm real estate has increased rapidly over the past several years while most other investments have performed in lackluster fashion, at best. Yet, farmers and their lenders almost universally agree that a given tract of farmland seldom generates adequate cash flow to meet production expenses, taxes, and debt amortization under present circumstances. Nonetheless, there is a ready market for each tract of farmland offered for sale. This has led to the myth that farmers are being locked out of the land market by high spending foreign buyers, along with wealthy Americans seeking rapid capital gains. Lively speculation surrounds the questions of who is buying farmland, how are sales being financed, and what proportion of the land purchases will remain in productive agriculture.

WHO IS BUYING?

The question of who is buying farmland derives in part from a fear that active farmers or ranchers have somehow been placed at a competitive disadvantage in the land market in recent years. Farm real estate values have increased rapidly and consistently, and are over twice as high as they were 5 years ago.[1] Though farm income in current dollars is higher than in those years prior to 1971, per capita disposable income of farmers is still only 90 per cent of that of nonfarmers.

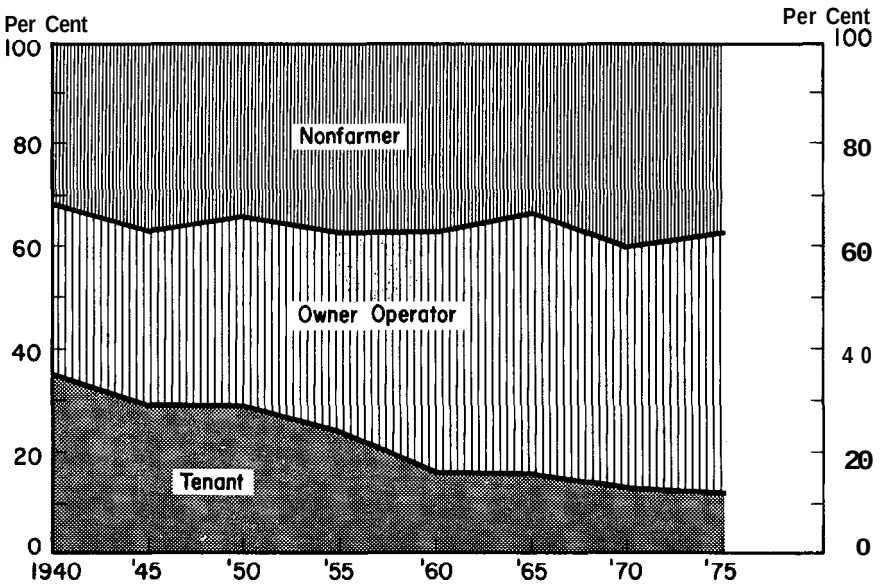
During the same period, alternative investments have not fared as well as farmland. Returns on common stock, though strong in the early 1970's, reflected the seriousness of the recent recession and have not responded as hoped during the present economic recovery. Urban real estate investments such as Real Estate Investment Trusts have proven disappointing-to-disastrous for many. The principal investments, apart from farmland, that have performed consistently well over the last several years have been suburban-rental housing and the investment by the homeowner in his home. Thus, if money flows out of investments with poor returns into those performing well, one would expect additional nonfarm investment in farm real estate.

For the year ending March 1, 1976, 23 million acres of farm real estate changed hands. This was up 15 per cent from the 20 million acres in 1971, but down substantially from the recent peak of 42 million acres transferred during the year ending March 1, 1974. The number of transfers for 1976 was down only 5 per cent below 1971 levels, reflecting the larger tracts being transferred. It is revealing to note that 63 per cent of farm real estate transfers during 1975 were to active farmers, about the same as over the past 3 decades (Chart 1).[2] Though the balance of transfers were to nonfarmers, one must

1 Marvin Duncan, "Farm Real Estate Values," Federal Reserve Bank of Kansas City *Monthly Review* (January 1977), pp. 13-20.

2 All yearly data are based on a year ending March 1, unless otherwise indicated.

Chart 1
FARM REAL ESTATE TRANSFERS BY TYPE OF BUYER



SOURCE: U.S. Department of Agriculture.

remember this includes retired farmers — and it is reasonable to assume that many of them are still actively investing in the asset they understand best (farm real estate). Examining the acres of land transferred, **70** per cent in **1975** went to active farmers — not much different from the **69** per cent in **1971.** Further, the proportion of value (of farmland) transferred to active farmers was also essentially the same.

Another indication of who is buying farmland can be found by examining the ownership characteristics of Federal Land Bank (FLB) borrowers. The **FLB's** proportion of all credit extended for farm real estate purchases varies annually around an upward trend. The proportion for calendar **1976** was 30 per cent, compared to 21 per cent in **1971.** Thus, FLB loans constitute a substantial proportion of all loans — and it is not unreasonable to expect the FLB loans to approach a representative sample of farmer-borrowers buying land using conventional mortgages. FLB data for calendar **1975** indicate full-time and part-time individual farm operators accounted for 95 per cent of FLB borrowers and for 85 per cent of the amount loaned during that year. Further, this proportion has changed little over the past several years.

Thus, one can reasonably conclude that farmers continue to compete successfully for available farm real estate. Moreover, these data support the usual and more qualitative answer to the question of who is buying farmland. That answer is active farmers are buying it — much of the time.

Many observers of U.S. agriculture would be reassured to know that farmers purchase this much of the farm real estate offered for sale. But, it is also reasonable to ask what kind of farmer is doing the purchasing. Data on the financial position of purchasers, and the size of their operations, should yield some indication of the relative ability of different farmers to compete for farmland.

Farmers planning to enlarge their operations probably account for the bulk of the purchases. Most real estate transfers now become part of

another farm, rather than being used after the transfer as a complete farm. In 1976, 60 per cent of all transfers were intended for use as part of another farm and only 29 per cent were intended for use as a complete farm. In 1971, the proportions of intended use were much the same. Equally interesting, only 24 per cent of complete farms sold then were used as such after the property changed hands. In 1956, however, the proportion of sales used as whole farms was 60 per cent while 33 per cent were used as part of another farm. Thus, over the past 20 years, the farmer seeking to enlarge his farm has emerged as the major participant in the land market.

Although not all Federal Land Bank loans are for real estate purchases, about two-thirds of them probably are used to purchase land or refinance land purchases. Thus, borrower-profile data may yield some useful information about land purchasers. In calendar 1975, the average Land Bank borrower closing a loan farmed 956 acres—a farm almost 2.5 times as large as the average U.S. farm—and had a debt-to-net worth (leverage) ratio of 53 per cent, almost three times the ratio for all farms in the United States. Furthermore, this average borrower had a net worth of just over $300,000, over $24,000 in net nonfarm income, and over $26,000 in net farm income. Nonfarm income levels reflected both the level for the year prior to closing the FLB loan and the level reasonably expected to continue, at least for the following year.

Young Land Bank borrowers, those under 35 years of age, accounted for almost one-fourth of all loans the Land Bank closed during 1975. These young farmers were more highly leveraged than the average Land Bank borrower. They had a debt-to-net worth (leverage) ratio of 69 per cent compared to 53 per cent for all FLB borrowers. Nonetheless, they farmed about as much acreage as the average for all Land Bank borrowers. Three-fourths of these young farmers received nonfarm income averaging $23,400, as compared to nonfarm income of $24,600 for the average FLB borrowers.

Thus, the picture that emerges is that of well-capitalized, aggressive, and successful farm operators. Often, the farm family is earning substantial nonfarm income. Such farm operators are able to compete aggressively with nonfarm investors for available farm real estate. Additionally, such farmers are often able to spread fixed ownership costs of new land acquisitions over total operated acreage. Thus, it is not difficult to conclude that farmers are very tough competitors in the farm real estate market.

Indeed, some recent research suggests that the stiffest competition for farm real estate will probably come from other farmers." Furthermore, the very largest farms may not have the greatest advantage in bidding for land because of higher marginal tax rates on profits and possible inefficiencies resulting from very large size. The greatest threat to the small-family farm may very well be the larger family farm—intent on expansion and doing so from a solid financial base.

What About Part-Time Farmers?

Data suggest the proportion of real estate transfers to be used as part-time farms is a quite stable proportion of all transfers—about 12 per cent in each of the past few years. The proportion of complete farms that were to be used for part-time farming after the sale was only half (2 per cent) of what it had been 6 years earlier. The proportion of sales that were part of another farm before transfer but were to be used for part-time farming after transfer had fallen by one-third to 4 per cent.

Though the proportion of transfers to be devoted to part-time farming is stable, there is substantial variance among different sections of the country. The strongest demand occurs close

3 Duane G. Harris and Richard F. Nehring, "Impact of Farm Size on the Bidding Potential for Agricultural Land," *American Journal of Agricultural Economics.* Vol. *58,* May 1976, pp. 161-69.

to major industrial centers and large cities where off-farm job opportunities exist. As might be expected, the proportion is highest (and growing) in the Northeast at **20** per cent for the year ending in **1976.** The Northern Plains and the Corn Belt are lowest with 4 and ***8*** per cent, respectively. The Southern Plains and Mountain States are close to the national average at 13 and **11** per cent, respectively. Thus, demand for farm real estate by part-time farmers is not insignificant—and is quite important in certain areas of the country.

What About the Foreign Buyers?

A number of factors contributed to increased interest in U.S. farmland by foreign investors. Among them were rapid increases in U.S. farm income and real estate values, increased income levels in the Organization of Petroleum Exporting Countries (OPEC), and the perceived risk of political instability in many countries. However, the increase in rumors about such foreign interest probably exceeded the actual growth in interest. Few farming communities were immune to the rumors about Arab sheiks, Japanese industrialists, and German princes—all with cash in hand, willing to pay almost any figure for U.S. farmland. Not all rumors were without foundation, of course. Foreign buyers were interested and still are. Discreet inquiries were made through brokers—and some property has changed hands.

Unfortunately, it is difficult to obtain data in any detail on the actual involvement of foreign buyers in the U.S. land market. A recent study in Iowa did attempt to ascertain the volume of inquiries and purchases of farmland.[4] Iowa researchers found that rumors greatly overstated actual activity by foreign buyers. Inquiries greatly exceeded transactions. They identified relatively few actual transactions. Current inflows of foreign capital into Iowa were very small compared to total capital in the agricultural sector—and only a very limited number of transactions (10) could be documented in the study. Foreign interests were careful buyers; willing only to pay what they considered a reasonable price for land. The tracts purchased were top-quality farmland devoted to cash-grain production. Local farmers continued to operate the land for grain production, renting it from the new owners. Community reaction varied from indifferent to negative depending in large part on whether the sale was perceived as bidding up local land values. Although it would be difficult to document, it is likely that the Iowa experience is fairly typical of what has happened in other states--especially in the Middle West and Great Plains.

PROBABLE USE OF RECENTLY SOLD LAND

Despite continued concern over removal of arable land from agricultural use, recent sales data are reassuring. For the 48 contiguous states, ***85*** per cent of the farm real estate purchases in **1976** involved land that was expected to be in agricultural use ***5*** years after the sale. Furthermore, **92** per cent of the dollar value transferred represented farmland expected to be used for agricultural use for at least ***5*** years after the transfer. The expected uses, ***5*** years into the future, of the farm real estate acres purchased in **1976** are presented in Table **1.** Since the more intensive use is listed when two or more future uses are indicated, it is likely that the proportion of transferred acres remaining in agriculture after ***5*** years will exceed the 93 per cent indicated in the table. Some would suggest that future food needs around the world are such that all agricultural land should remain so-even after transfer, and this contention may contain a grain of truth. In any case, the proportion of

[4] **Michael Boehlje, Craig Cume, Neil Harl, and Duane Harris, *Non-Resident Alien Investment Activity in Iowa Farmland: A Preliminary Analysis.* Economic Report Series, Department of Economics, Iowa State University, Ames, Iowa, September 1975.**

Table 1
FARM REAL ESTATE TRANSFERS: PERCENTAGE DISTRIBUTION OF ACRES BY PROBABLE USE OF PROPERTY 5 YEARS AFTER PURCHASE, BY REGION, FOR THE YEAR ENDING MARCH 1*

(Per Cent of Total Acres Transferred)

REGION	AGR'L ONLY		FORESTRY		MINERAL		RECRE-ATION		RURAL RESIDENCE		SUB-DIVISION		COMM'L/ INDUSTRIAL		OTHER	
	1975	1976	1975	1976	1975	1976	1975	1976	1975	1976	1975	1976	1975	1976	1975	1976
Northeast	80	82	+	1	+	+	2	2	9	7	7	5	1	1	1	1
Lake States	94	93	+	1	+	+	2	2	4	2	1	1	+	+	+	1
Corn Belt	96	95	+	1	+	+	1	+	2	2	1	1	+	+	+	+
Northern Plains	98	99	+	+	+	+	1	+	+	+	+	+	+	+	+	+
Appalachian	82	83	3	1	1	+	2	1	6	5	4	5	1	1	2	2
Southeast	72	85	17	7	+	+	1	3	5	3	2	1	1	+	1	1
Delta States	89	97	4	+	+	+	2	+	2	2	1	+	1	+	2	+
Southern Plains	93	94	+	+	+	+	2	2	2	2	1	+	+	+	1	1
Mountain	99	92	+	+	+	+	+	4	+	1	+	2	+	+	+	+
Pacific	90	96	8	+	+	+	+	1	1	1	1	+	+	+	+	1
48 States	93	93	2	1	+	+	1	2	2	2	1	1	+	+	1	1

*When more than one probable use was indicated, the most intensive use was assigned to the transfer. Therefore, percentages to the right of "agriculture only," are believed to be biased upward.
+ Less than 0.5 per cent.

SOURCE: U.S. Department of Agriculture.

transferred acres remaining in agriculture was slightly higher in 1976 than 5 years earlier.

WHERE AWE THE FUNDS COMING FROM?

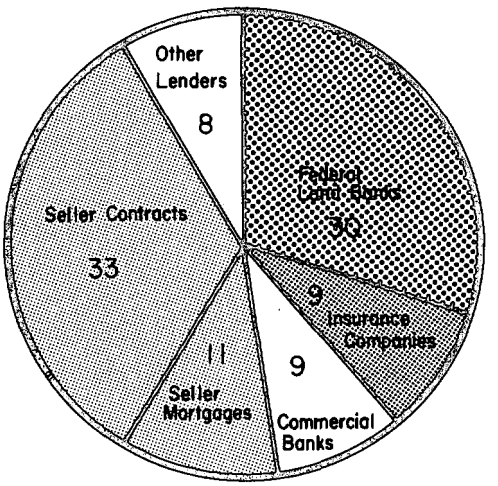
Credit financing continues to play a very important role in farm real estate transfers. During the year ending March 1, 1976, most of all such transfers involved credit financing. Of the $12.2 billion worth of real estate transferred, over $10.2 billion involved credit financing. The proportion of transfers involving credit has increased about 10 per cent per decade since the middle **1940's** but has remained relatively stable since 1973.

The ratio of debt-to-purchase price for credit-financed farm real estate transfers has increased slowly, varying around an upward trend. For the United States, debt represented 76 per cent of the purchase price in 1976, up from 73 per cent in 1971. The 1976 proportion for those geographic areas including Tenth District states varied from 73 per cent in the Mountain States to 76 per cent in the Corn Belt—a range on the low side of the U.S. average.

Chart 2 indicates the distribution of loan funds by lenders. Sellers of farm real estate are, themselves, the largest source of credit financing for farm real estate purchases. Sellers provided 44 per cent of total funds used to finance transfers for the year ending in 1971. This proportion is in line with the experience of recent years.

Three-fourths of seller credit is in the form of contracts for deed rather than seller mortgages. A prime benefit of contracts for deed, from the sellers' viewpoint, is that they permit the capital gains from the land sale to be spread over the life of the contract. However, to qualify for such tax treatment, downpayments must be less than 30 per cent and the interest rate more than 4 per cent. The purchaser may benefit as well. Lower downpayments are typically required by the seller; probably because the title is not transferred at the time

Chart 2
SOURCES OF
FARM WEAL ESTATE CREDIT
(For the Year Ending March 1, 1976)



SOURCE: U.S. Department of Agriculture.

of sale, possibly reducing risk. **A** 1972 study suggests, however, seller contract financing may result in about a 5 per cent higher selling price than would otherwise be **true.**[5] This is partially offset, as a rule, by an interest rate somewhat lower than is typical in seller-mortgage financing.

Commercial banks have typically provided 9 to 11 per cent of the credit for farm real estate transfers. Because **demand** deposits and relatively short-term certificates of deposit are the sources of a significant amount of loanable funds, banks are reluctant to participate heavily in real estate financing. They do, however, undertake a modest amount as an accommodation to customers and for a variety of other reasons.

Federal Land Banks, borrower-owned

5 **Robert D. Reinsel, "Effect of Seller Financing on Land Prices,"** ***Agricultural Finance Review,*** **Vol. 33, July 1972, pp. 32-35.**

cooperatives, have aggressively increased their proportion of total farm real estate lending since the approval of the Farm Credit Act of 1971. This legislation allowed the Banks to loan a greater percentage of the appraised value of farm real estate in addition to streamlining bank decision processes. Since the year ending March 1, 1970, to the present time, FLB's have increased their share of farm real estate credit financing by 2.5 times, from 12 per cent to 30 per cent of total credit financing.

Life insurance companies have, in the past couple of years, committed increasing amounts of loan funds to the farm real estate market. Though their proportion of the credit extended declined through the 1960's and early 1970's, disappointing experience with urban real estate lending has caused them to once again look favorably at farm real estate lending. Most of the companies with farm loan departments are increasing their commitments to farm real estate loans. Nonetheless, life insurance companies had only $.4 billion more in outstanding farm loans on January 1, 1977, than did all banks. Commercial banks and life insurance companies each hold about 9 per cent of the outstanding farm real estate debt. Thus, though their role will apparently increase, it will continue to be dwarfed by that of both sellers and Federal Land Banks.

Farmers Home Administration (FmHA), a government agency, holds only 6 per cent of the outstanding real estate debt. However, FmHA funds provide an important source of credit for those farm operators who are unable to obtain real estate financing elsewhere. Although FmHA's total outstanding real estate debt holdings are relatively small, they are nonetheless equal to about half that type of debt held by all U.S. life insurance companies—and had increased at a faster rate until recently.

SUMMARY

Despite fears to the contrary, farm operators are competing aggressively for the farm real estate offered for sale. Active farmers presently account for a slightly higher proportion of purchases than 20 years ago. While some foreign investment in farmland has taken place, it appears to represent only a very small proportion of land sold. Further, annual national surveys indicate that nonfarm investors are not making greater inroads into farm ownership than had been the case since World War II.

Data do suggest that farmers presently purchasing farmland are larger, more aggressive, and enjoy substantially higher-than-average personal income from both farm and nonfarm sources than previously. Thus, it is likely that the toughest competitors for farmland a family farmer will face is another farmer—probably a somewhat larger farmer.

The aggregate balance sheet of agriculture is strong. Farmers' liabilities are only 16 per cent of their assets and that equity permits them to incur much additional real estate debt. Moreover, farmers are able to compete so aggressively for farmland because of their favorable balance sheets and ready access to real estate financing—both adequate and flexible enough to meet a range of needs. Farmers' reputations for meeting debt obligations in a timely and responsible manner have, in large part, made this access to credit possible.

Generally, the farmland purchased is moving into strong hands—able to withstand limited periods of adversity. However, it must be remembered that some purchasers, especially new entrants and younger farmers, have high debt-to-asset ratios (low equity). These operators may have great difficulty generating adequate cash flow to meet production expenses, debt amortization, and living expenses during periods of adversity. Loan restructuring, disciplined cost cutting, and additional off-farm income may be the keys to survival for these farmers if adversity strikes.