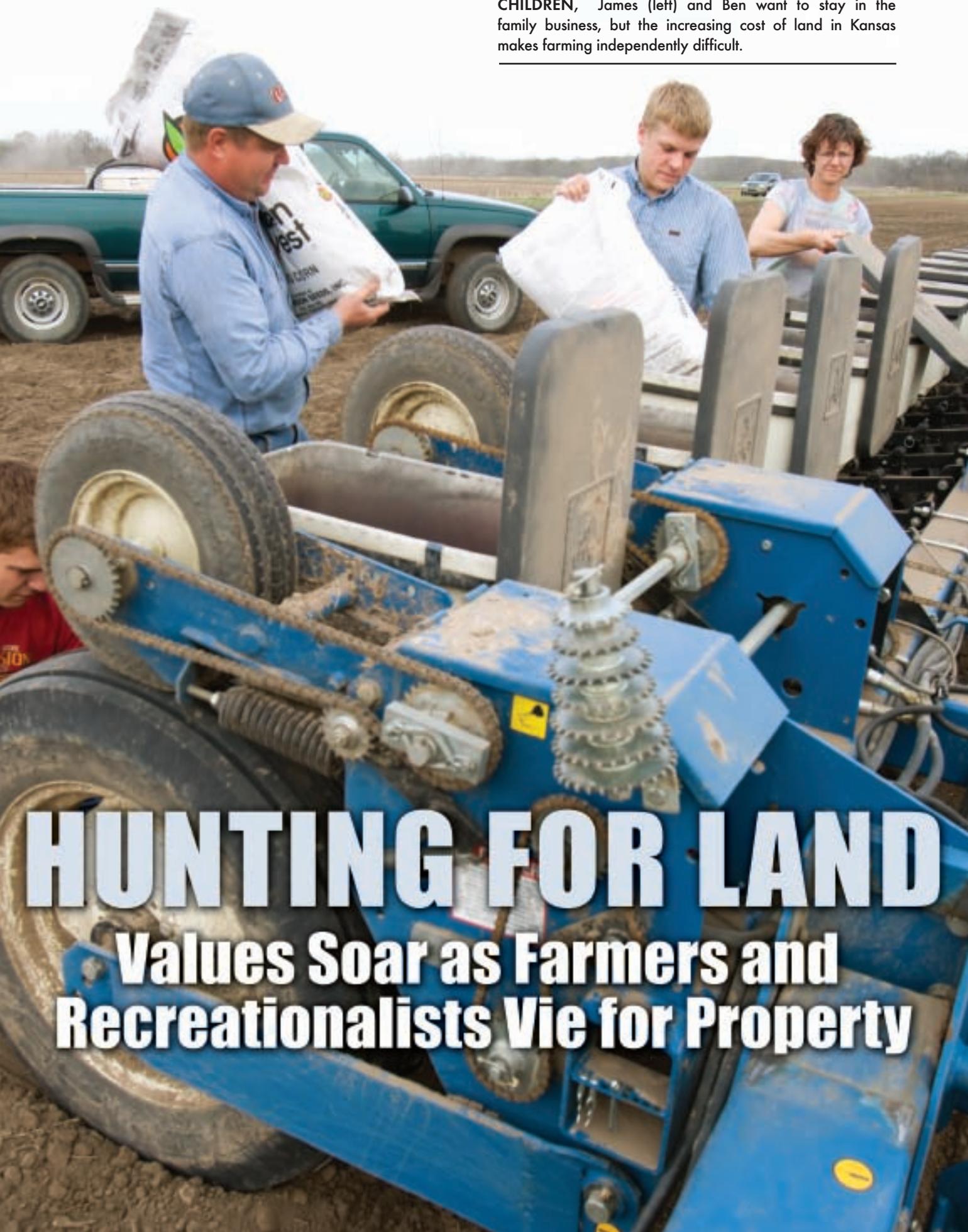

TWO OF JOHN AND KENNA HUTTOS' TEENAGE CHILDREN, James (left) and Ben want to stay in the family business, but the increasing cost of land in Kansas makes farming independently difficult.



HUNTING FOR LAND

Values Soar as Farmers and Recreationalists Vie for Property

After building his small enterprise from scratch the past 20 years, John Hutto wants to further expand the family farm now that his two sons are nearly ready to join the business. There's just one problem.

Hutto keeps getting outbid.

Although he's willing to pay even more than the already high asking prices for acreage near his farm in rural southeast Kansas, his offers get trumped—but not by other farmers.

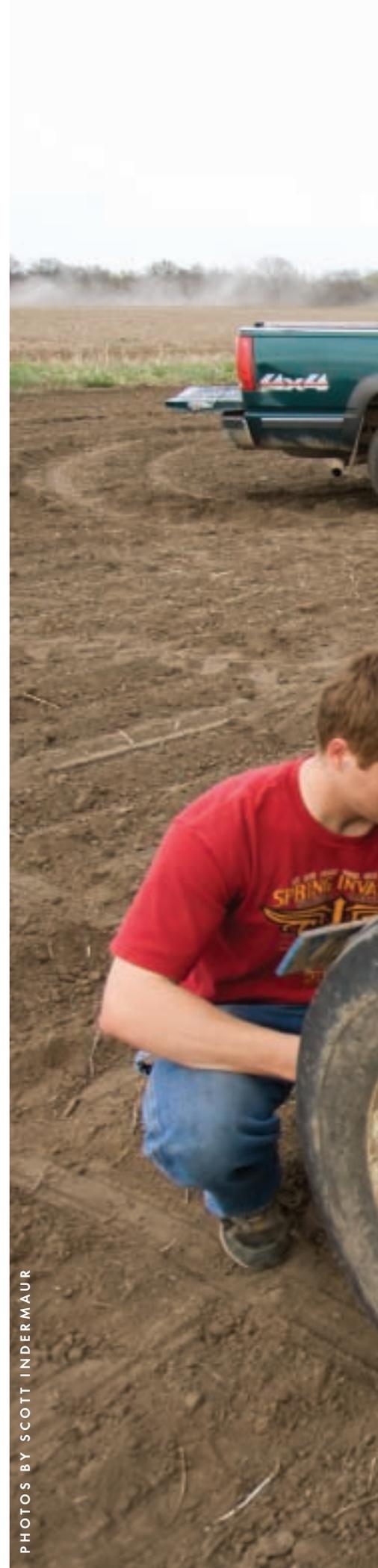
“Every property seems to have someone who wants to hunt on it, fish on it or build a house on it,” Hutto says. “We just can't compete.”

During the last few years, farmland values around the nation have been booming. While this increase in value may be advantageous for long-time landowners, soaring values make purchasing land difficult for new farmers or those wanting to expand, says Nancy Novack, an associate economist with the Center for the Study of Rural America at the Federal Reserve Bank of Kansas City.

Novack recently researched surveys of agricultural credit conditions conducted by several Federal Reserve Banks. The surveys targeted areas around the country that account for the majority of the nation's agricultural cash receipts, including the Tenth Federal Reserve District.

Last year, farmland values around the country saw their highest increase in a one-year period since 1981. Farmland in the Tenth District jumped an average of 10 percent to about \$820 per acre, according to the U.S. Department of Agriculture's Land Values and Cash Rents 2005 Summary. This increase was in line with the nation's 11 percent hike. Around the country, land averaged \$1,510 per acre, according to the USDA.

Gains in quality farmland in major agriculture areas ranged from 7.2 percent to 17.4 percent in late 2005, according to the



PHOTOS BY SCOTT INDERMAUR

Federal Reserve surveys. Ranchland values continued to post double-digit gains in many areas. And despite high energy prices, irrigated farmland values remained solid, according to the surveys.

Driving values upward are: strong farm income, tax advantages, low interest rates and an increasingly high demand for nonfarm use of land.

“A variety of factors are influencing these gains, depending on the location of the land,” Novack says. “But nonfarm demand has emerged as a dominant force.”

Setting the scene

Bob Kahnk doesn't know much about the corn crops growing on a portion of his land in Anselmo, Neb. Kahnk isn't a farmer, but rather a doctor who recently purchased almost 600 acres of farmland with a business partner, Ted Brown. Kahnk hopes claiming a stake in central Nebraska will benefit his pocketbook and enhance his family's free time.

“There's only so much land, so it's a good investment,” he says. “And certainly recreation is a big part of it.”

Kahnk was looking for a safe, long-term venture, as well as a way to spend time outdoors with his three young sons hiking and hunting the turkey, deer, pheasant and quail there. He leases out about 50 acres to a local farmer and eventually may lease the remaining pastureland to urbanites looking for a hunting getaway.

“It certainly has the potential to cash out,” Kahnk says. “That would be nice.”

This is quite possible, says Troy Langan, manager of the Hunting Lease Network, an Omaha-based company that leases recreational land around the country.

Landowners, many of whom are farmers, realize that renting portions of property to hunters is a lucrative way to supplement their income, Langan says. The Hunting Lease Network, which acts as the middleman between the landowner and hunter, has seen rapid growth in business in the past few years. Nationwide, hunting, fishing and other outdoor activities are becoming increasingly popular, especially among those who don't live



near wildlife or undeveloped land. These urbanites are willing to pay large amounts to enjoy outdoor recreation—whether it's buying the land themselves or leasing it from others.

In addition to recreational use, other conditions also have fostered the boom, Novack says. In 2004, net farm income set a new record high. Although incomes retreated somewhat in 2005, they were still the second-highest on record. Healthy crop receipts, continued government payments, strong cattle prices and widespread drought relief aided the boost in incomes.

Several factors have triggered land purchasing, according to Novack's research. The volatility of the stock market in recent years has left investors looking for a safe place to grow their money. Low interest rates and tax benefits have added support for increased land values. Mortgage rates for farmland purchases have been at historic lows in recent years. But the steady rise in short-term interest rates



BOB AND JANEEN KAHNK bought farmland in central Nebraska in part for recreational use. They spend most weekends there with their sons (from left) Riese, 2; Cole, 8; and Jared, 5.

during the past two years, as well as stronger stock market performance recently, could somewhat offset this, Novack says.

Tax benefits are another incentive. Tax-deferred exchanges under section 1031 of the tax code allow property owners to sell land and delay capital gains taxation, if similar property is purchased. Farm real estate brokers report that such exchanges often occur at strong prices, in part because tax code rules give buyers a short time span to complete the purchase.

Implications

Soaring farmland values are favorable for some and pose challenges for others, Novack says.

For many older landowners, their farm-

land is their retirement, and the stronger the gains, the better. The boost in equity for landowners with debt on their properties is welcomed by bankers. However, bankers also realize new loans for land at high prices are risky and often cannot be serviced with farm income alone. Granting loans for land that may not be used solely for farming adds a new challenge for lenders.

Farm credit conditions are solid, and two years of strong incomes helped improve farm loan portfolios. Repayment rates on farm loans have risen in the past few years, according to the Federal Reserve surveys. And the number of requests for renewals or extensions on farm loans also has improved; most bankers reported less requests.



Although overall debt levels have been on the rise in recent years, farmers seem to be in a favorable position to service this debt, Novack says. Another indication of strong farm finances is the low debt-to-asset ratio.

Meanwhile, high prices make it difficult for those wanting to enter or expand the farming business. There are barriers, especially for young farmers with limited credit histories.

Farmland Value Gains

FEDERAL RESERVE DISTRICT AGRICULTURAL CREDIT SURVEYS



San Francisco *
Nonirrigated: 17.4%
Irrigated: 15.5 %
Ranchland: 1.8%

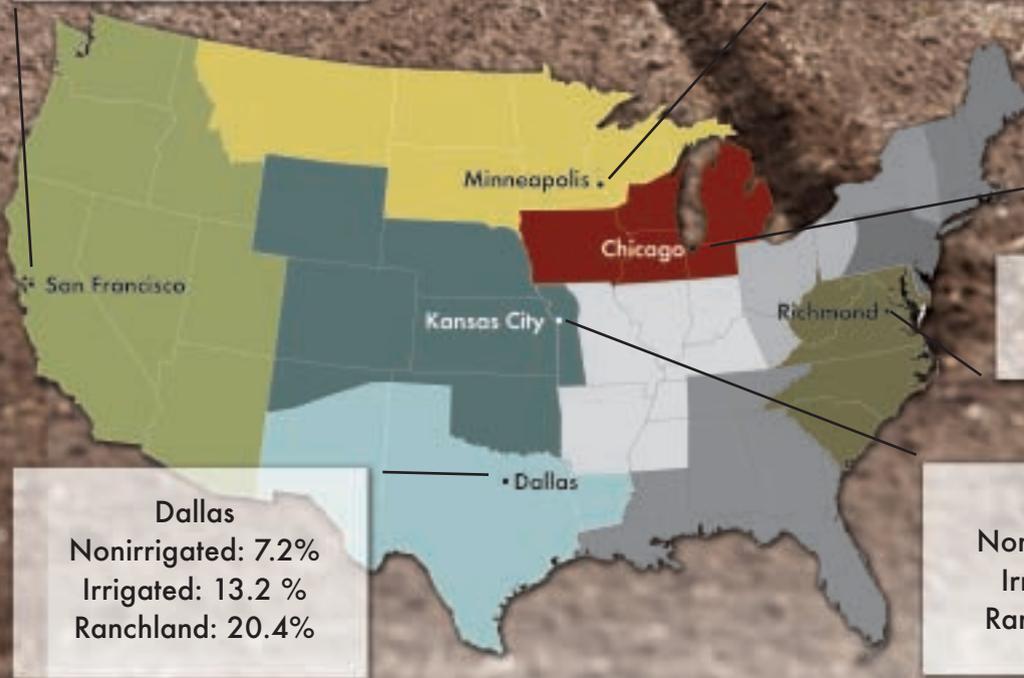
Minneapolis
Nonirrigated: 15.5%
Irrigated: 12.5 %
Ranchland: 16.4%

Chicago
All 10.0%

Richmond *
All 57%

Dallas
Nonirrigated: 7.2%
Irrigated: 13.2 %
Ranchland: 20.4%

Kansas City
Nonirrigated: 9.2%
Irrigated: 6.1 %
Ranchland: 12.5%



Federal Reserve Banks in half of the 12 Districts recently surveyed agricultural bankers for insight into agriculture credit conditions. The percent changes in land values were measured from the end of the fourth quarter of 2004 through 2005. The surveys were conducted by the Kansas City, Chicago, Dallas, Minneapolis, San Francisco and Richmond Districts, which account for roughly three-fourths of the nation's agricultural cash receipts. Results show conditions vary greatly from one region of the United States to another. Increases in the Tenth District are average for the country's rising land values. The strong gains reported by the Federal Reserve surveys are in line with those conducted by other industry analysts.

* The San Francisco and Richmond surveys are based on a smaller sample than the other District surveys.

Dave Davis has noticed this trend in Broken Bow, a town of 3,900 in the heart of Nebraska, where he's worked as a farm and ranch real estate agent for 22 years.

"There's just as much (real estate) activity, but it's only in a few hands," Davis says. "There's a lot of outside money (coming into town). ... It's difficult for first-time buyers."

"Pretty darn high" land values and competition with out-of-town investors is forcing some farmers into renting land—often from outside investors—rather than buying it, Davis says. And other farmers opt to purchase land in more remote and often less desirable areas.

This nonlocal demand can be beneficial to long-time landowners. But in central Nebraska, many of these farmers are reluctant to sell because of the attachment to their land, which they don't want to see taken out of production even after they retire, he says.

"Urban sprawl remains a major force behind the demand for farmland near metropolitan centers," Novack says. "As suburban areas expand, productive farmland is taken out of production at high prices."

Taking farmland out of production for recreational use does not seem to have an impact on food production in the District, Novack says, adding it certainly could in other areas of the country. Rising values do make U.S. farm commodities less competitive, and therefore, some producers are looking for higher-value products to reap more returns from the land.

Agriculture outlook

This past year in particular, John Hutto has realized just how difficult it will be for his children to enter the farming industry. Conditions are different than when he started; land that Hutto purchased to farm corn, soybeans and wheat is now worth more than six times its original value.

He knows his sons won't be able to start farming on their own.

"It would be necessary to do it together," Hutto says. "There's just so much capital needed to start."

Expansion has been slow, competitive and

expensive. He was lucky to have secured a price a few years ago for the 300 acres he purchased last spring. And he's thankful that he started looking for that land years ago—it's the couple's retirement and their children's future.

"To buy land, at least short-term, is unprofitable," Hutto says. "It will be a cash flow drain to us for a couple years. ... I'm not going to get out of debt. It's just not going to happen."

But, he says, "Things are cyclical. I think we're pretty close to the top of it (the land market boom)."

With this in mind, Hutto endorses his children's career choice to farm.

Novack's research shows the farm financial picture overall remains healthy.

Net farm income posted a record high in 2004, and last year was the second largest on record as a result of steadily strong livestock prices, according to Novack's research. However, crop prices dipped because of large supplies. As a result, nearly one-third of farm income was derived from government payments, which reached a record \$23 billion last year.

Farm income is expected to fall this year, but remain above the long-term average, according to the USDA's February farm income report. Bankers are concerned about the impacts of rising energy prices on their farm customers. Costs of fuel, fertilizer, irrigation and transportation all have risen significantly in recent years.

It's not possible to predict when this boom in land values will actually level off, but it's almost certain that it will, Novack says. Although changes in the agriculture industry are certain, the overall outlook is promising.

"It's an interesting time to be in farming," Hutto says.

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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

AGRICULTURAL CREDIT CONDITIONS: BOOMING FARMLAND VALUES, BY NANCY NOVACK

www.KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.