CENTER FOR THE STUDY OF RURAL AMERICA
Federal Reserve Bank of Kansas City

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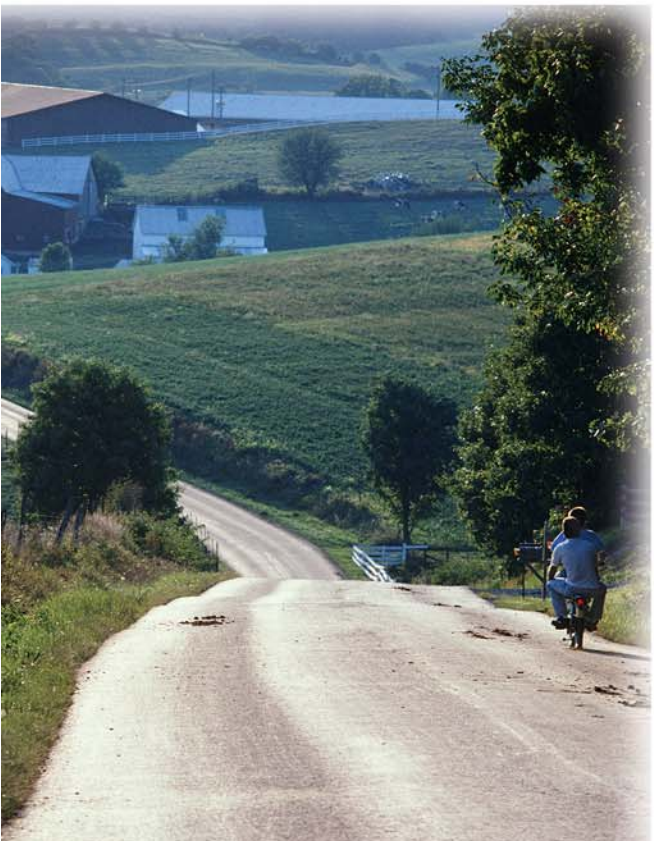

Rising Farmland Values: Some Implications for Rural America

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Land is the biggest asset on the farm balance sheet—and the largest source of farm debt. Thus, farmland values play a significant role in the financial condition of U.S. farmers. Farmland values depend heavily on the revenue that the land generates. Yet despite a depressed agricultural economy in recent years, farmland values have posted surprisingly solid gains. These gains have helped stabilize farm balance sheets during the recent income difficulties in agriculture.

While most analysts do not expect a repeat of the 1980s crash in land values, important risks in land markets merit watching. The behavior of land values going forward—whether land values remain elevated or they fall—has implications for both farmers and their communities.

The recent strength in farmland markets

Farm economy fundamentals have been weak in recent years. Commodity prices have been soft overall. Although last year's drought pushed up crop prices, the dry weather led to poor crops in many regions, leaving many farmers with much lower total revenues. Still, farmland values continued to rise. Forces beyond the profitability in agriculture appear to be driving these gains.

Across the nation, the value of farmland continued to stay strong. In quarterly surveys of agricultural credit conditions in the Federal Reserve System at the end of 2002, gains for the year in farmland values ranged from 5 percent in the Dallas District to 13 percent in the Minneapolis District. In the Kansas City District, farmland values rose 7 percent in 2002, led by areas with healthy Main Street economies and good crop yields.

For cropland, conditions in agriculture are the most direct influence on land values. When crop receipts rise, land values typically strengthen, while farm income shortfalls often lead to softer land values. In 2002, areas of severe drought saw weaker gains in farmland values. In good times or bad, however, the supply of farmland for sale may be limited in many local markets. In such cases, farmland values can rise from the fierce competition among farmers wanting to expand operations to capture economies of scale made possible by new technologies.

Direct farm effects can also be masked by other factors. Government payments boost farm income, and future payments are quickly capitalized into the value of land. Because payments are perceived as guaranteed returns, at least for the life of a farm bill, farmers bid them into the selling price of land. USDA recently estimated that roughly 25 percent of the total value of farmland reflects government payments.

Government payments, however, do not explain all of the gains in many places. Because rural America is a recreational retreat for many people, nonfarm demand has become an important component in the value of farmland. Recreation and development demand has boosted farmland values in areas that offer scenic amenities. Nearly half of all respondents in the Kansas City District listed hunting, fishing, and recreation as major factors in the recent run-up in farmland values. A third of the respondents listed residential and development as additional reasons for land purchases.

In recent years, low interest rates have also reduced borrowing costs and boosted the buying power of both farm and nonfarm borrowers. Interest rates on farm real estate loans in the Kansas City District have fallen more than 2.5 percent on average over the last two years. There are also some indications that investors have redirected money from poorly performing stock markets toward less volatile land investments.

What are the risks in the current farmland markets?

Despite the recent strength, several factors pose risks to land values in the period ahead. The future of farm policy and government payments is perhaps the biggest risk to farmland values. Deficits have returned to the federal budget, putting farm spending under more scrutiny. For example, the drought assistance package that recently passed Congress had to be offset by reductions in other farm bill spending. As the USDA study suggests, cutbacks in government payments to farmers could have potentially big implications for farmland values.

Fluctuations in farm income also pose risks to farmland values. If drought conditions persist in 2003, farm income could dip in many regions and weakness in farmland values could become more widespread. Even if production and farm income rebound in 2003, as current forecasts suggest, government payments would fall as a result, dampening the overall rise in farm income.

Finally, historically low long-term interest rates could rise when the national economy stabilizes. Higher borrowing costs would eliminate some of the support low interest rates have provided farmland values.

Some implications for the rural economy

Rising farmland values create mixed impacts for rural areas. Strong farmland values have created significant equity for land owners. This equity is an additional source of collateral for new or existing farm loans and has enabled some borrowers to restructure their farm debt in the face of low prices and production losses. Farmland also serves as a retirement plan for American farmers, and rising land values contribute to their return on investment.

Farmland values have a huge bearing on the fiscal condition of many local governments throughout the nation. Property taxes are a critical source of revenue for many communities. In addition to supporting infrastructure, such as roads, property taxes represent about one-fourth of all public school funding. If farmland values decline, local governments could be left searching for revenue streams to replace lost tax receipts on farmland.

While farm lenders and local governments clearly benefit from rising land values, there are some negative implications. Ultimately, higher land values drive up production costs and reduce the competitiveness of U.S. producers. South American producers are already able to produce soybeans for substantially less than U.S. farmers, an advantage gained mainly due to differences in land costs. Higher costs of owning and renting land have made it difficult for the next generation of farmers to enter the farming business. It is also becoming more difficult for farm buyers to finance land purchases with farm earnings alone, and farmers increasingly rely on nonfarm income to support their farm operations. Three-fourths of respondents on one Kansas City survey indicated that the majority of their farm borrowers used off-farm income to support their farm operations.

Farmland values are influenced by farm and nonfarm factors. While rising land values are beneficial for farm equity and local tax bases, they also boost production costs, reducing the ability of rural industries to compete on cheap land costs. Ultimately, farmland values will be one of the keys that determine the future competitiveness of rural areas.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City
December 31, 2002

Highlights from the fourth quarter survey.*

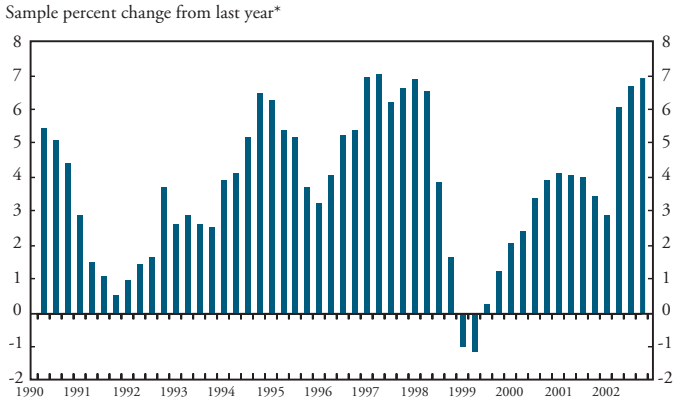
- Despite the widespread drought, district farmland values held up in 2002. Missouri posted the largest gains, while gains in the Mountain states were more moderate due to the drought. For the year ending December 31, annual gains for the district were 6.9 percent for nonirrigated cropland, 5.0 percent for irrigated cropland, and 5.9 percent for ranchland.
- District bankers indicated that the majority of farmland was purchased by farmers. But, 14 percent of respondents noted that sales to farmers accounted for less than half of all farmland sales. Of the farmland not purchased by farmers, investment, recreation, and residential were the most commonly cited reasons for farmland purchases.
- Despite strong farmland values, farm credit conditions showed some signs of weakness in 2002. The drought resulted in a shortage of cash flow for many producers. As a result, loan repayment rates slowed throughout the year and renewals or extensions moved up.
- The district farm commodity price index edged up in the fourth quarter. The increase was supported by higher prices for livestock—slaughter cattle, in particular. Crop prices remained above year-ago levels but softened relative to the previous quarter. Since December, livestock prices have posted further gains. Corn and soybean prices have held steady, but wheat prices have fallen sharply.
- Interest rates on new farm loans moved lower in the fourth quarter. At the end of the quarter, interest rates on new farm loans averaged 7.60 percent for operating loans, 7.64 percent for machinery and intermediate-term loans, and 7.22 percent for real estate loans. Since December, interest rates in national money markets have held steady.

Note: 283 banks responded to the fourth quarter survey.

*Please refer questions to Nancy Novack, associate economist, at 816-881-2423 or nancy.l.novack@kc.frb.org.

Nonirrigated Cropland Values

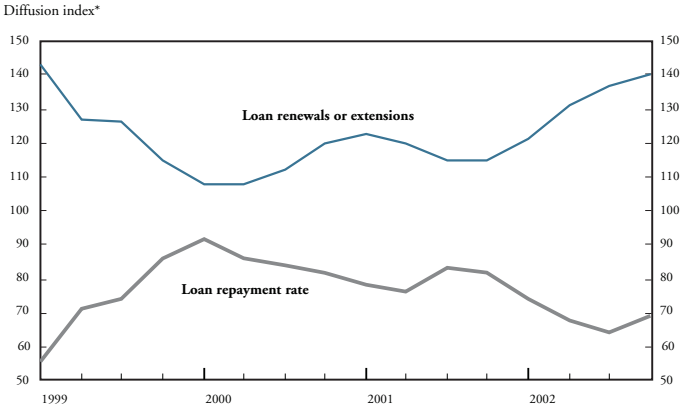
Tenth District



*Percent changes are calculated using responses only from banks reporting in both the past and the current quarter.

Farm Credit Conditions

Tenth District



*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

Summary of Economic Conditions

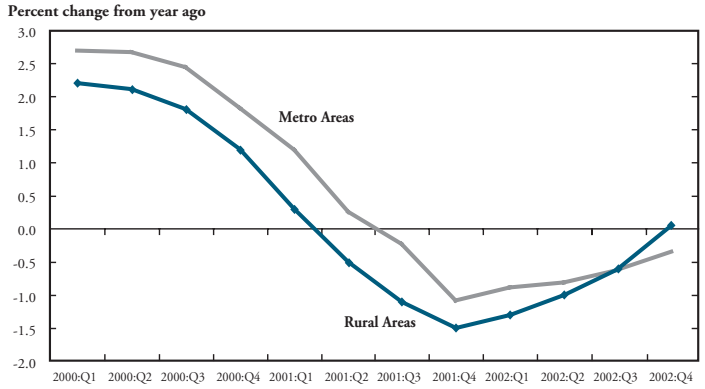
Highlights from the fourth quarter*

- The rural nonfarm economy continued to strengthen as 2002 came to a close. During the fourth quarter of 2002, employment opportunities continued to improve in rural areas as the number of rural jobs returned to year-ago levels. After closing the gap between rural and metro job growth in the previous quarter, rural job growth outpaced metro job growth in the fourth quarter.

- Job gains in service and government sectors offset job losses in rural factories. After a slight contraction for most of the year, service-producing jobs edged up 0.6 percent above year-ago levels in the fourth quarter. Government employment growth also edged up during the fourth quarter of 2002. Despite improvement, rural manufacturers continued to face a weak recovery as factory jobs remained 2.5 percent below year-ago levels.

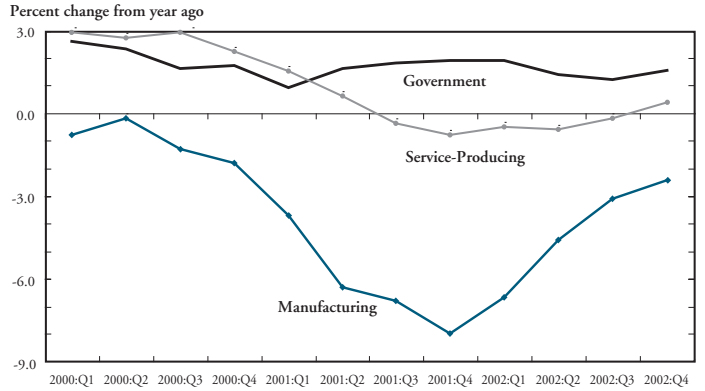
- Despite a seasonal slowdown, rural residential construction activity remained robust. The value of residential construction remained 10.8 percent above year-ago levels, despite the seasonal decline in the fourth quarter. Single-family building activity continued to pace the construction market. In the fourth quarter, the value of single-family building permits remained 15 percent above year-ago levels, despite the seasonal contraction.

Rural and Metro Job Growth



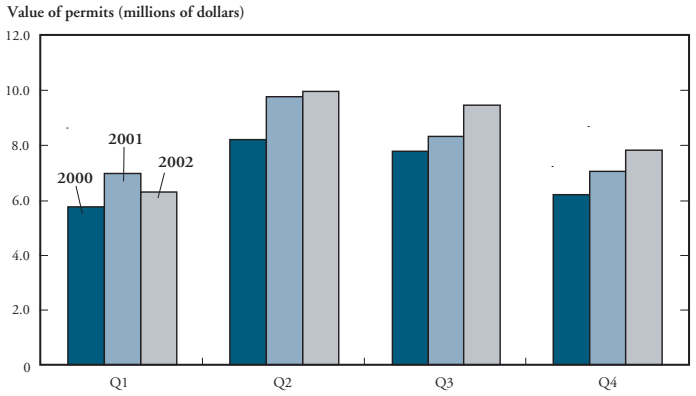
Source: Bureau of Labor Statistics

Rural Job Growth by Sector



Source: Bureau of Labor Statistics

Rural Residential Construction



Source: Bureau of Labor Statistics

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For more current analysis on the state of the rural farm and nonfarm economies, visit our website at ***www.kc.frb.org***.

Note: Data for all tables are not seasonally adjusted.