Image: Dreamstime.com

# DOWN – BUT FAR FROM OUT – ON THE FARM

Debbie Carlson
April 23, 2012 // Barrons.com

Over the past decade, prices for U.S. farmland have boomed, capped by a 20%-plus jump last year in some of America's most fertile regions.

The bad news: The torrid gains are coming to an end. The good: A crash, like those that followed the tech, dot-com, and housing bubbles, is unlikely. Instead, farmland prices probably will return to a more normal ebb and flow of modest gains and declines.

The recent bonanza for U.S. agriculture was driven by stepped-up food demand from China and other emerging lands, and the rising use of corn-based ethanol as a gasoline additive in the U.S. Throw in good domestic demand for farm products, plus crop subsidies from the federal government, and it's no wonder farmers' incomes hit record highs.

As well, many have been plowing their harvest riches back into the ground, buying more land and shunning stocks and bonds. In 2002, Iowa land averaged $2,083 an acre; in 2011, it went for $6,708.

But now, the U.S. Department of Agriculture predicts, net farm income will decline nationally, by 6.5% this year. Some U.S. crop subsidies may end as Congress seeks to whittle spending. One big subsidy for ethanol production already is gone, while mandates to blend more of the biofuel with gasoline aren't materializing. And China's growth is slowing, which could reduce agricultural exports to that giant nation in the short run – although they're almost certain to remain substantial over the long term.

Farmland had a bumper year in 2011. The National Council of Real Estate Investment Fiduciaries' Farmland Index rose 8.7% in the fourth quarter alone, with prices in every farm region rising. For the entire year, many of the Federal Reserve banks' agricultural surveys showed stout price appreciation, with the Kansas City branch recording a gain of 25% over 2010's already heady level; Chicago, a 22% jump; and Dallas, a 14% rise.

The sharpest advances were in the Corn Belt, parts of which have enjoyed a quarter-century of consecutive annual farmland price increases. Says David Oppedahl, business economist at the Chicago Fed: "This is a factor of high corn prices -- and the profit that can be made from farming corn or soy." The Corn Belt roughly includes Illinois, Indiana, Iowa, Michigan, and parts of Kansas, Minnesota, Missouri, and Nebraska. It includes the Federal Reserve's Seventh District, where some of the best agricultural land in the world is found.

Corn is the top U.S. crop, and prices have been particularly strong because of good demand and low inventories. Farmers are planting 2012's crop now, and the USDA expects 95.9 million acres to be sown, the most since 1937. Using the agency's average yield estimate of 164 bushels an acre, and a harvested acreage estimate of 89 million acres, output would be a record 14.5 billion bushels. That would go a long way to alleviate current tight supplies. And if foreign demand slips, prices could fall.

In fact, says Michael Duffy, an economics professor who directs the Beginning Farmer Center at Iowa State, the U.S. ships nearly one-third of its agricultural production abroad. Marry lower crop exports with a leveling-off in ethanol production, and Brent Gloy, director of the Center for Commercial Agricultural at Purdue University, sees farmers' having less ability to buy land.

Or, as Vance Ehmke, head of Vance and Louise Ehmke Farms in western Kansas, puts it: "Land is a net beneficiary of residual net income. If you don't have any money left over, you don't buy land." Ehmke has lots of experience backing his judgment; his family first homesteaded in 1886, and now farms 9,000 acres.

Lower income shouldn't lead to a crisis on the farm. For one thing, farmers' debt-to-income ratios are historically low. And, says Karl Setzer, commodity-trading advisor for Iowa grain merchandiser MaxYield Cooperative, many have sold grain forward at higher prices than the current ones.

"This is not going to inspire another John Cougar Mellencamp song" about misery in the heartland, Setzer quips. But projected lower farm income will curb farmers' appetite for acreage expansion. That's important because, in great part, farmers -- not outside investors -- have been bidding up farmland prices for years.

This, says Jose Minaya, head of natural resources and infrastructure investments at TIAA-CREF, creates an illiquid market not always hospitable to outsiders. The pension-fund manager's $464 billion in assets include $2.5 billion in farmland investments.

But a key dynamic is changing. In Iowa, Professor Duffy says, more than 55% of farmers are 65 or older, and farmers elsewhere in the U.S., on average, aren't much younger. As these folks fade from the scene, some of their land will go to their families, but a big portion will go on the market.

Comments Ken Morrison, editor of the online newsletter Morrison on the Markets: "If a lack of land helped to drive up prices, then more land could depress it."

Charlie McNairy, CEO of International Farming, a North Carolina agricultural investment-management firm, sees an upside: Lower prices would give younger people willing to embrace new technology a chance to choose farming.

However, to boost crop output and profits, McNairy adds, farmland must be used more effectively. "There's a growing gap between progressive farmers and those that resist new technologies," he says.

Farmers who don't embrace agronomic changes to boost output also may be forced to sell land, says McNairy, whose family has farmed in the U.S. since 1827.

TIAA-CREF's Minaya says there are natural cycles for all real estate. Maybe that's why, after a long summer of blazing gains, farmland looks ready to resume its normal seasons of advance and decline.