FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

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Farmland values decline again in first quarter

A recent survey of 500 agricultural bankers in the Seventh Federal Reserve District indicates that the downtrend in farmland values continued in the first quarter. However, the survey also shows that, for many areas, the rate of decline in farmland values has slowed and that the number of transactions in farm real estate has picked up in recent months. As of March 31 District farmland values, on average, were down 2.9 percent from 3 months earlier, down 17 percent from a year ago, and down nearly 45 percent from the peak in the early 1980s. Although substantial, the latest quarterly rate of decline is somewhat lower than the 3.3 percent recorded in the fourth quarter of 1985 and well below the average of 5.2 percent in the five quarters prior to last fall.

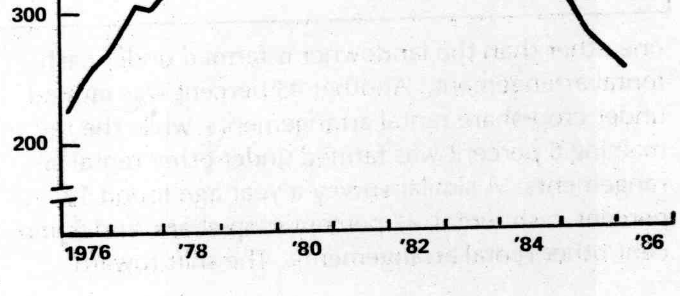
Bankers in each of the five District states reported that farmland values declined in the first quarter (see map on page 2). The steepest declines, 4 percent, were reported by bankers from Iowa and Michigan. Bankers from the District portion of Wisconsin reported a first quarter decline of 3 percent, while those from Illinois and Indiana reported declines of 1.5 percent. Compared to the quarterly patterns in 1985, the latest measures show a significant slowing in the rate of decline in farmland values for Indiana and Iowa and a modest slowing in Wisconsin. In contrast, the first quarter decline in Illinois farmland values, although comparatively modest, follows on the heels of no change in the fourth quarter of 1985. And in Michigan, the first quarter decline substantially exceeds the pattern for that state in previous quarters.

The pace in farm real estate transfers has picked up in recent months, no doubt contributing to the slower rate of decline in many areas. Overall, 42 percent of the bankers indicated that the number of farm units sold in the past six months was up from a year ago, while only 27 percent reported a decline. The remaining 31 percent of the bankers reported that the number of farm units sold was unchanged from a year ago. In terms of the acreage associated with the farm units sold in the past six months, 35 percent of the bankers reported an increase from year-earlier levels while 23 percent reported a decline. The pick-up in farm real estate transfers is particularly evident in the responses from bankers in Illinois, Indiana, and Iowa. In those three states the percentage of bankers noting an increase in both the number and the acreage of recent transfers exceeded those reporting declines by a margin of roughly 2 to 1. Conversely, the proportion of bankers in Michigan and Wisconsin that noted declines in farm real estate transfers substantially exceed those reporting an increase.

Cash rental rates for farmland also declined significantly over the past year. But as has been the case in recent years, the decline in cash rents in most areas has not matched the drop in land values. On average, bankers that responded to the latest survey indicated that cash rental rates for farmland this year are down nearly 15 percent from a year ago. Bankers from Illinois reported the highest cash rental rates, averaging about $110 an acre, and the smallest decline, 12 percent, from a year ago. Cash rental rates in Indiana and Iowa averaged just over $85 an acre, reflecting declines of 14 and 18 percent, respectively, from last year. In Michigan and Wisconsin, cash rental rates for farmland have declined 15 and 17 percent, respectively, and average in the low-to-mid $50 per acre.

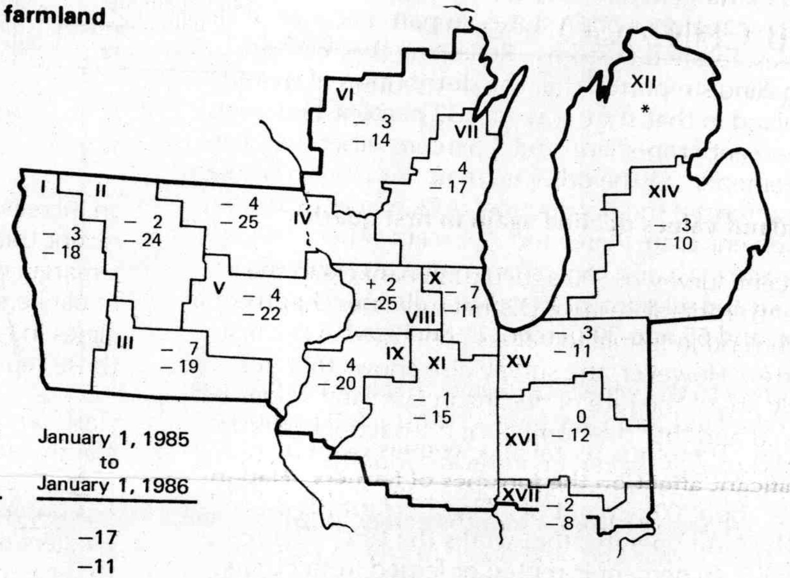
While cash rental rates have declined considerably, the shift toward crop-share rental arrangements continued over the past year. Although practices vary widely by geographic regions, bankers that responded to the latest survey, on average, indicated that about 49 percent of the farmland that is operated by someone other than the landowner is farmed under cash

District farmland values have fallen to mid 1970 levels



Percent change in dollar value of "good" farmland

Top: January 1, 1986 to April 1, 1986
Bottom: April 1, 1985 to April 1, 1986

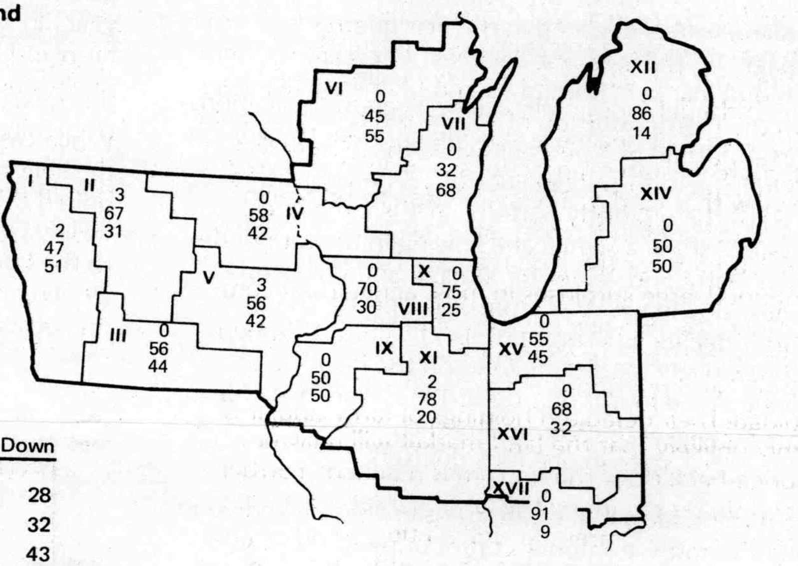


	January 1, 1986 to April 1, 1986	January 1, 1985 to January 1, 1986
Illinois	−2	−17
Indiana	1	−11
Iowa	−4	−22
Michigan	−4	−10
Wisconsin	−3	−16
Seventh District	−3	−17

*Insufficient response.

Percent of banks reporting the current trend in farmland values is;

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	1	71	28
Indiana	0	68	32
Iowa	2	56	43
Michigan	0	56	44
Wisconsin	0	42	58
Seventh District	1	59	40

one other than the landowner is farmed under cash rental arrangement. Another 45 percent was farmed under crop-share rental arrangements, while the remaining 6 percent was farmed under other rental arrangements. A similar survey a year ago found 52 percent cash rental, 42 percent crop-share, and 6 percent other rental arrangements. The shift toward crop-share rental arrangements reflects the earnings squeeze in agriculture which has encouraged operators of rented farmland to shift from the comparatively high "fixed" costs associated with cash rents to the lower costs that have typically prevailed in recent years when production and marketing risks were shared with landlords.

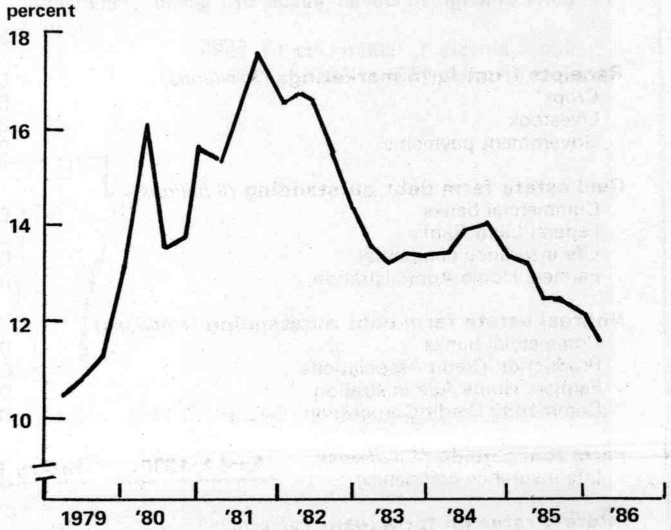
Rental arrangements vary widely by states and by geographic regions within states, in part, because of long-established customs. Reflecting this, bankers from Illinois reported that the distribution of rented farmland in that state was split 32 percent cash rent, 63 percent crop-share, and 5 percent other rental arrangements. At the other extreme, Wisconsin bankers characterized the distribution as 76 percent cash rent, 17 percent crop-share, and 7 percent other. The split between cash and crop-share rental arrangements was 46 and 48 percent in Indiana, 49 and 45 percent in Iowa, and 65 and 30 percent in Michigan.

Contrary to the widely-held view that farmers typically own the land that they farm, a substantial portion is rented. Therefore, rental arrangements can have a significant affect on the fortunes of farmers. Nationwide, about 60 percent of all land in farms is owned by the farm operator that works the land. The remaining 40 percent is rented or leased from others. Among District states the share of land that is leased or rented ranges from nearly 60 percent in Illinois to 25 percent in Wisconsin. The relevant shares for Indiana and Iowa are about 50 percent, while for Michigan it is about 33 percent.

Future trends in farm real estate values are uncertain. However, an increasing number of analysts are suggesting that the land market may be close to a bottom. Although not applicable to all areas, indications that the rate of decline is slowing and that the volume of farm real estate transactions is picking up support the view that land markets are close to bottoming. Recent declines in interest rates have also provided some support for the land market. Nevertheless, with continued large surpluses in most agricultural commodities, the growing backlog of balance sheet restructuring that is needed for many heavily-indebted farmers, and the desire of farm mortgage lenders to liquidate their defaulted holdings of farm land, it is highly unlikely that the land market will register a bounce-back once the bottom is reached. Further uncertainties regarding the land market stem from possible future Gramm-Rudman budget cuts in government farm support programs. Although most believe that a balanced federal budget, over the long-term, would benefit U.S. agriculture, the short-run consequences of large mandated Gramm-Rudman cuts, if they were to occur, could be detrimental to the land market.

Most District bankers apparently share the view that the land market is close to a bottom. In the most recent survey, 59 percent of the bankers thought that

Farm mortgage rates at District agricultural banks are down to 1979 levels



land values would hold stable in the second quarter. The bulk of the remainder, 40 percent, thought land values would continue downward in the second quarter. This is the first time in several quarterly surveys that the number of bankers expecting land values to stabilize has exceeded those expecting declines. The strongest expectations of a leveling-off in land values this quarter came from bankers in Illinois and Indiana. Hopefully these expectations of a leveling-off in land values will prove correct, providing some relief from the deteriorating financial conditions that have battered so much of U.S. agriculture in recent years.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*					
Crops*	December	16,524	-2.4	7	17
Livestock	December	10,024	-8.0	33	52
Government payments	December	5,569	-7.9	-6	-4
	December	932	N.A.	-52	-48
Real estate farm debt outstanding *($ billions)*					
Commercial banks	December 31	11.4	3.5†	12	22
Federal Land Banks	December 31	44.7	-3.5†	-9	-9
Life insurance companies	December 31	11.8	-1.3†	-5	-7
Farmers Home Administration	December 31	10.9	1.9†	6	12
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	December 31	35.7	-9.2†	-10	-9
Production Credit Associations	December 31	14.0	-12.5†	-22	-27
Farmers Home Administration	December 31	18.4	-2.1†	12	19
Commodity Credit Corporation	December 31	17.6	76.0†	102	63
Farm loans made *($ millions)*					
Life insurance companies	December	144	29.6	119	-8
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	April 1	12.36	-2.7†	-8	-11
Real estate loans	April 1	11.70	-4.7†	-12	-13
Commodity Credit Corporation	April	7.25	-4.9	-26	-30
Agricultural exports *($ millions)*	February	2,445	-3.6	-18	-28
Corn *(mil. bu.)*	February	121	-27.3	-28	-24
Soybeans *(mil. bu.)*	February	92	8.7	27	16
Wheat *(mil. bu.)*	February	78	3.7	-16	-33
Farm machinery sales[P] *(units)*					
Tractors, over 40 HP	March	2,979	-9.1	-45	-54
40 to 139 HP	March	2,344	-3.4	-45	-50
140 HP or more	March	635	-25.3	-48	-65
Combines	March	156	-32.5	-31	-49

N.A. not applicable
*Includes net CCC loans.
†Prior period is three months earlier.
[P]Preliminary

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