Another View on Farmland Prices

by Ray L. Brownfield

Rex Wilcox, Philip Raup, and John Scott, Jr. in the First Quarter 1992 issue of *CHOICES*, each identify certain factors which will affect land values through the year 2000.

Our experiences at Capital Agricultural Property Services, Inc., in managing purchases for investors and selling agriculture real estate throughout the United States lead us to believe that agricultural land values are developing into two tiers of value. High quality land is in one tier, and is typified by adequate rainfall or aquifers so that long-term irrigation needs can be met, nearness to shipping points or processing plants, and minimal sensitivity to environmental regulations. The nominal price of this kind of land will appreciate at an annual rate of 2-3 percent.

This type of land is in tight hands today, and current owners are receiving a very adequate return of possibly 5-8 percent. There is a great deal of interest in this type of land by investors, such as pension funds, who feel that it will be a very good investment for at least the next 10 years.

On the contrary, the second tier consists of marginal land in areas of minimal rainfall, primarily dependent upon dryland farming or irrigation, with possibly a porous soil structure, and with climatic factors limiting economic crop production and diversification. This class of agricultural land will have trouble maintaining its current market value, and may even depreciate by 1-2 percent per year over the next eight-year period.

As the three authors indicate in the First Quarter 1992 issue, many factors are going to strongly affect land values. If the GATT negotiations should be brought to a successful conclusion, it is quite possible that those areas of the United States in which feed grains are produced would profit tremendously from increased commodity prices which would be reflected in net earnings and therefore, land values. In fact, this action could possibly set off a new round of inflationary times in these areas of United States agriculture.

The 1995 farm bill will undoubtedly restrain the use of nitrogen and pesticides in the interest of clean water. Regulations limiting or restricting the use of certain pesticides and fertilizers could reduce overall net farm income. Again, it is likely that these types of regulations would have a greater negative effect in areas where soils are classified as marginal through either their topographical features or organic contents.

A capital gains tax reduction appears to be deferred, but after the election, it is possible that it will be restored, and if enacted, would have a positive effect on land prices and provide more optimism in the market.

There has probably been no better time than now to utilize cheap money to purchase a long-term investment which will support (if high quality) a cash return of 5-8 percent providing an internal rate of return of 7-11 percent. This is very competitive in today's market as opposed to alternative investments, such as stocks or bonds, which still have a great deal of uncertainty.

In summation, I believe that the price of high quality land has the opportunity to show steady to moderate gains (2-3 percent) over the next three to four years after which, if GATT becomes reality and if government regulations are less onerous, buyer demands will increase resulting in an acceleration of farmland prices nearing 4-5 percent per year through the year 2000.

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