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FEDERAL RESERVE BANK OF CHICAGO

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LETTER

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THE DOWNTREND IN DISTRICT FARMLAND VALUES accelerated in the third quarter. A recent survey of 550 agricultural banks in the Seventh Federal Reserve District indicates that farmland values, on average, fell 4 percent during the three months ending September 30. The magnitude of the latest decline was among the highest for any quarter since the general downtrend in land values began in 1981. Following the large decline this summer, District farmland values are off about 10.5 percent from a year ago and off nearly 23 percent from the 1981 peak. Many bankers believe that farmland values will continue to trend lower during the current quarter because of an overhang of land available for sale and little apparent interest in acquiring land among potential buyers.

Gauging trends in market prices of farmland has always been difficult. But in recent years, the difficulty has mounted. Many of the surveyed bankers commented about the paucity of farm real estate transactions on which to base a judgement of farmland prices. Even in a "good" year, only 3 to 4 percent of farm real estate changes ownership. In recent years that proportion apparently has dwindled. Moreover, of the transactions that have taken place, a higher proportion often involve some element that stretches the traditional guideline of "an arm's length transaction between a willing buyer and a willing seller" for appraising the market value of land. In an increasing number of cases, land owners hard pressed by financial burdens have had to liquidate some or all of their land in a short period of time in order to meet overdue debt payments. Because these conditions make it difficult to judge land values, general measures of land value trends should be interpreted with caution when extrapolating to local regions or areas.

Reports from bankers in all five District states noted the third-quarter downtrend in farmland values. The indicated rate of decline, however, varied widely (see map on page 2). Michigan bankers reported the smallest decline, just under 2 percent. Bankers from Indiana and Wisconsin reported declines averaging 2.5 to 3 percent. The largest declines were reported by bankers from the

Seventh District portion of Illinois (4.5 percent) and those from Iowa (5.5 percent). The pronounced decline in Iowa farmland values continues a trend that has prevailed for several quarters, culminating in a year-to-year decline of more than 16.5 percent for that state and a peak-to-trough decline of more than 30 percent.

The downtrend in farmland values reflects the depressed income returns to land ownership in recent years and expectations for future returns that have been vastly damped from what was the case in the 1970s. The low income returns stem from several factors, including loss of export markets, an inordinate number of crop farmers whose production has suffered from adverse weather, and the prevailing depressed conditions of livestock farmers in recent years. Because of these conditions and a growing pessimism that overall conditions are not likely to improve significantly in the near-term, many potential land buyers have pulled to the sidelines, waiting for land values to fall to the point where the depressed current and expected returns once again offer an acceptable return on an investment in land. Simultaneously, the supply of land available for sale has expanded. A large part of the increase in land available for sale reflects the small, but growing, proportion of farmers who are in severe financial stress and need to restructure their balance sheets by liquidating assets in order to repay their debt.

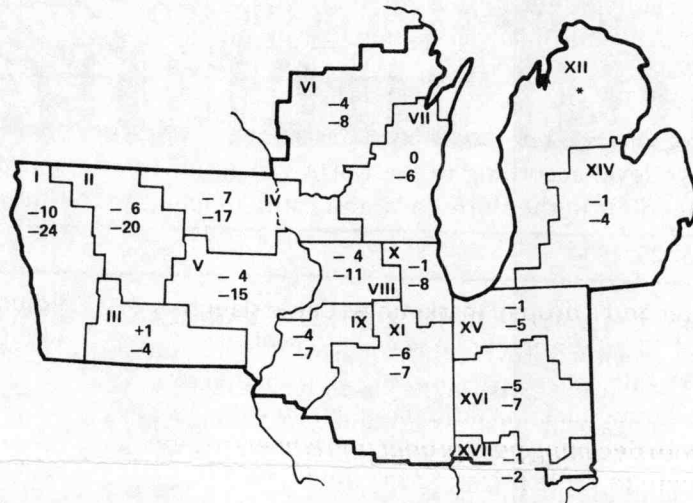
Financing costs no doubt have also been a factor in declining farmland values. Interest rates charged by all farm mortgage lenders this summer were up from year-ago levels. But from a broader perspective, the declining incidence of seller-financing may account for a large share of the decline in land values that is related to interest rates. In the late 1970s and early 1980s, sellers annually accounted for 36 to 41 percent of the credit extended to finance farm real-estate transfers that involved some debt financing. But that proportion has declined significantly the past couple of years, falling to 28 percent in the year that ended in March 1984. Compared to seller financing, conventional financing usually involves higher interest rates and a lower transaction price on the land being transferred. Consequently, the

Percent change in dollar value of "good" farmland

Top: July 1, 1984 to October 1, 1984
Bottom: October 1, 1983 to October 1, 1984

	July 1, 1984 to October 1, 1984	October 1, 1983 to October 1, 1984
Illinois.....	-5	-8
Indiana.....	-3	-5
Iowa.....	-6	-17
Michigan.....	-2	-6
Wisconsin.....	-3	-8
Seventh District.....	-4	-10

* Insufficient response.

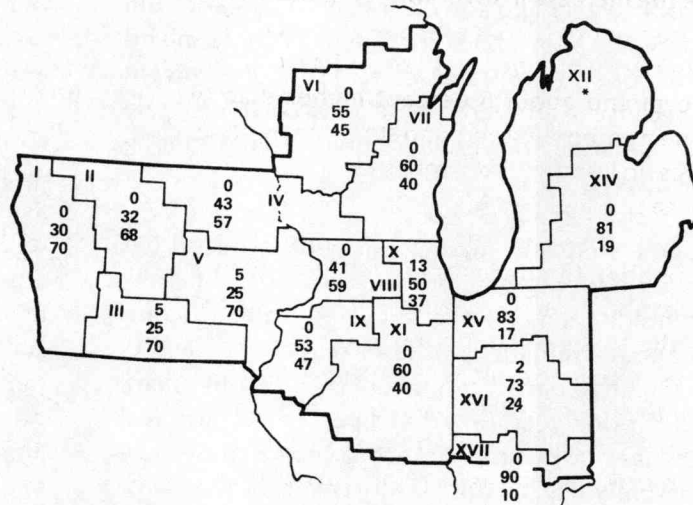


Percent of banks reporting the current trend in farmland values is:

Top: Up
Center: Stable
Bottom: Down

	Up	Stable	Down
Illinois.....	1	55	45
Indiana.....	1	78	20
Iowa.....	2	31	67
Michigan.....	0	82	18
Wisconsin.....	0	55	45
Seventh District.....	1	53	46

* Insufficient response.



replacement of seller financing with higher rate sources of commercial financing implies that the measured declines in land values may have been exacerbated by the changing shares in sources of financing.

The implications of declining farmland values are many and diverse. All land owners have experienced a loss in net worth compared to what was the case when land values were at the peak. Those who have sold land at recent prices have converted that paper loss into a realized loss, that, in many cases, has represented a devastating blow to the sellers' hopes for a future livelihood. Even those who have not sold land recently have experienced a sharp loss in nominal equity and an even sharper loss in the inflation-adjusted value of their equity. But from the perspective of the long-run health of U.S. agriculture in a changed market environment, declining land values represent a positive adjustment.

To the extent that low returns to farmland represent a re-emergence of the excess production capacity in U.S. agriculture, lower land values will allow some land to be attracted into other uses. In addition, lower land values lead to a lower economic cost of production for U.S. agricultural commodities, better enabling those commodities to compete in world markets that value the U.S. dollar so highly. Without offsetting cost reductions in land and other resources, a continuation of the high value of the dollar would steadily erode world market shares for U.S. agricultural commodities.

Analysts see little likelihood of any near-term recovery in farmland values. Slightly over half of the bankers foresee stable farmland values during the current quarter. Less than 1 percent foresee an increase, and the remaining 46 percent anticipate declining land values this fall. The pessimism is most pronounced in

Iowa, where two-thirds expect declining land values this quarter. To a large extent, the pessimism reflects bankers' views that much of the financial stress of heavily indebted

farmers will have to be worked out by liquidation sales over the next few months.

Gary L. Benjamin

CATTLE ON FEED numbers are up 6 percent from the year-ago level according to the USDA's October 1 survey of feedlots in the thirteen largest cattle feeding states. The increase reflects a surprisingly large year-to-year rise in placements of cattle into feedlots during the third quarter and a drop in marketings. Cattle slaughter is expected to continue above year-ago levels for the rest of 1984 with an increase in fed cattle marketings. However, a downturn in cattle slaughter in early 1985 together with declining pork production is likely to lend some strength to cattle prices during the first quarter.

The quarterly thirteen-state survey, which accounts for about 85 percent of all cattle in feedlots, indicates that much of the increase in inventories is attributable to a rise in the number of heifers and cows on feed. Heifer and cow numbers were up more than 12 percent from last year's level and about 6 percent higher than two years ago. The number of steers and steer calves on feed October 1 was up less than 3 percent from a year ago and about equal to the 1982 level.

The increase in the inventory of cattle on feed was not evenly distributed across regions. Major cattle feeding states in the Midwest continued to register year-to-year declines, while the major southwest and plains states accounted for virtually all of the increase. Among the two District states included in the quarterly survey, feedlot inventories in Illinois were off 5 percent, while those in Iowa were down more than 20 percent from a year ago. The decline in Iowa was the largest of any of the thirteen states and it pulled Iowa's ranking among all states down to sixth place. Kansas, Oklahoma, and Texas recorded year-to-year gains of 19 percent or more in the number of cattle on feed.

The movement of cattle onto feedlots this summer, at 6.24 million head, jumped 12 percent from a year ago and was 7 percent above the third quarter total of 1982. Poor forage conditions, particularly in the Southwest, apparently accounted for much of the increased movement of cattle onto feedlots. This coupled with the poor returns to cow-calf operators could also account for the large rise in heifers and cows on feed.

Fed cattle marketings in the third quarter, at 5.67 million head, were down almost 4 percent from the same period a year ago, and at the lowest level since 1981. Nevertheless, commercial cattle slaughter and beef production during the third quarter were virtually

unchanged from the high level of a year ago. Cow slaughter continued to run well above year-ago levels throughout the summer months, although the margin did narrow in September. Even so, the sharp increase in the number of heifers and cows on feed suggests that the liquidation of beef cattle herds is continuing and will ultimately reduce beef supplies.

Cattle feeders in the thirteen states expect to market 5.70 million head of cattle during the final three months of 1984. That level of marketings would be more than 5 percent above the level of the comparable period of a year ago, and the largest fourth quarter marketing of fed cattle since 1978. The number of heavy-weight cattle on feed, up about 7 percent from a year ago, suggests an even larger increase in fourth quarter fed cattle marketings. While neither marketing intentions nor the inventory of heavy-weight cattle on feed are a precise indicator of marketings, it appears that commercial cattle slaughter during the fourth quarter will hold near or slightly above last year's level, in contrast to the earlier expectations of many analysts that slaughter rates would decline during the final quarter of the year.

During the first quarter of next year, however, cattle slaughter and beef production are expected to fall below year-ago levels. The number of light-weight animals on feed as of October 1, up less than 1 percent from last year's level, suggests that fed cattle marketings may be little changed from a year ago. Moreover, a slowing in the liquidation of cattle herds next year would likely reduce slaughter rates. The current USDA projection of beef production for the first quarter of next year points to an almost 3 percent year-to-year decline in beef supplies.

After holding in the mid-\$60s per hundredweight range through most of the third quarter, choice steer prices at Omaha began to fall in September. Through October, prices have held just slightly above the year-ago level of \$60 per hundredweight. Although fourth quarter slaughter is expected to continue at a high level, cattle prices are likely to show some strengthening by the end of the year. However, cattle prices are expected to average in the low \$60 per hundredweight range for the quarter. Declines in cattle marketings and hog production in the first quarter of 1985 will likely offset increased supplies of poultry, boosting cattle prices into the mid- to upper \$60 per hundredweight range.

Peter J. Heffernan

Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
Prices received by farmers (1977=100)	September	139	- 2.8	+ 2	+ 1
Crops (1977=100)	September	138	- 4.2	+ 2	+ 9
Corn (\$ per bu.)	September	3.00	- 3.8	-10	+40
Oats (\$ per bu.)	September	1.65	- 1.2	+ 6	+22
Soybeans (\$ per bu.)	September	6.03	- 7.2	-27	+16
Wheat (\$ per bu.)	September	3.42	0	- 6	+ 1
Livestock and products (1977=100)	September	140	- 2.1	+ 2	- 5
Barrows and gilts (\$ per cwt.)	September	47.60	- 8.3	+ 5	-24
Steers and heifers (\$ per cwt.)	September	60.10	- 2.0	+ 7	0
Milk (\$ per cwt.)	September	13.14	+ 0.3	- 3	- 3
Eggs (¢ per doz.)	September	58.4	- 0.3	-11	+ 3
Prices paid by farmers (1977=100)	September	165	0	+ 2	+ 5
Production items	September	155	0	+ 1	+ 3
Feed	September	130	- 2.3	- 9	+11
Feeder livestock	September	151	- 0.7	+ 3	- 9
Fuels and energy	September	200	+ 0.5	- 3	- 6
Producer prices (1967=100)	September	290	- 0.7	+ 2	+ 3
Agricultural machinery and equipment	September	338	+ 0.1	+ 3	+ 8
Fertilizer materials	September	234	+ 0.5	+ 7	- 1
Agricultural chemicals	September	458	+ 1.7	0	- 2
Consumer prices (1967=100)	September	315	+ 0.5	+ 4	+ 7
Food	September	304	- 0.2	+ 4	+ 6
Production or stocks					
Corn stocks (mil. bu.)	October 1	722	N.A.	-77	-67
Soybean stocks (mil. bu.)	September 1	175	N.A.	-49	-31
Beef production (bil. lbs.)	September	1.90	- 9.9	- 9	N.A.
Pork production (bil. lbs.)	September	1.14	- 3.1	-11	N.A.
Milk production (bil. lbs.)	September	10.8	- 3.7	- 4	N.A.

N.A. Not applicable



FEDERAL RESERVE BANK
OF CHICAGO
Public Information Center
P.O. Box 834
Chicago, Illinois 60690
Tel no. (312) 322-5111

AG001
HEAD-DEPT. OF AGRIC. ECON.
INSTITUTE OF AGRICULTURE
UNIVERSITY OF MINNESOTA
ST. PAUL, MN 55101

