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FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

August 1, 1986 Number 1687

Farmland values declined again in second quarter

District farmland values continued to trend lower in the second quarter, according to a recent survey of 525 agricultural bankers. The survey indicated that District farmland values, on average, declined 1.9 percent in the second quarter and 15 percent in the year ending June 30. Continuing a pattern that started in the latter part of 1985, however, the survey also indicated that the rate of decline in farmland values slowed further in the second quarter. The slowing rate of decline apparently prompted a majority of the bankers to anticipate a leveling off in farmland values this summer.

Bankers from four of the five District states reported that farmland values declined in the second quarter (see map on page 2). The exception was Wisconsin where bankers reported that land values as of mid-year were unchanged from three months earlier. Among the other four District states, the second quarter declines in farmland values ranged from 1 percent in the Seventh District portion of Illinois to more than 3.5 percent in Indiana. Iowa bankers reported a second quarter decline of slightly more than 2.5 percent while those in Michigan reported a decline of just over 1.5 percent.

The prevailing downturn in District farmland values has now lasted about five years. Over that period, District farmland values, on average, have dropped about 45 percent, triggering a huge loss in net worth for Midwest farmland owners. The decline in the Seventh District has substantially exceeded the 30 percent decline nationwide, as indicated by USDA statistics through the early part of this year. Among District states, declines from the peak so far range from about 30 percent in Michigan and Wisconsin to more than 55 percent in Iowa. In District portions of both Illinois and Indiana, the decline since the 1981 peak has been a little over 45 percent. With these declines, land values in most areas of the District have fallen back to levels that prevailed in the mid-1970s. On an inflation-adjusted basis, however, current District farmland values are more nearly comparable to the levels of the mid-1960s.

The only other instance in this century in which farmland values have registered such a profound decline occurred following the land boom that accompanied WWI. After peaking in early 1920, farmland values nationwide trended downward for 13 years, hitting bottom in 1933 during the depths of the Great Depression. During that period, farmland values nationwide plunged about 57 percent. And then, as now, some of the largest declines occurred in District states. From 1920 to 1933, farmland values declined 71 percent in Iowa, 65 percent in Illinois, 62 percent in Indiana, 44 percent in Wisconsin, and 40 percent in Michigan.

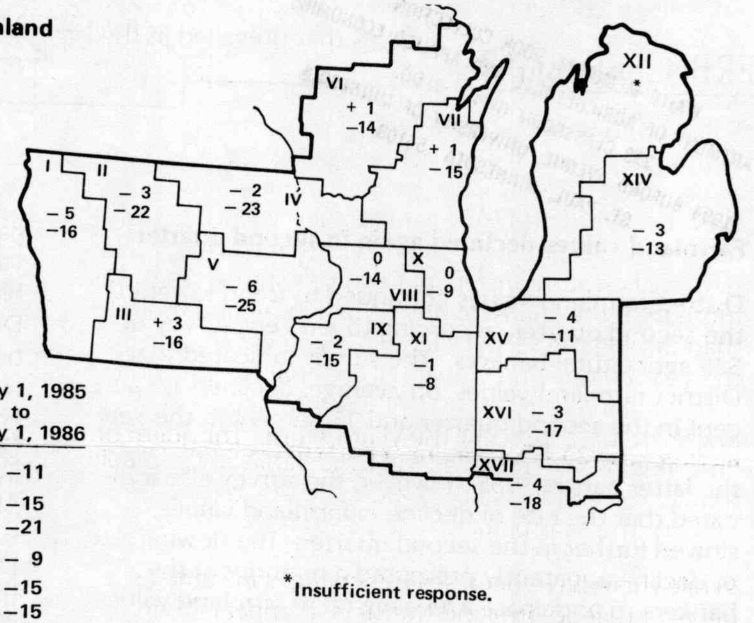
During the current cyclical downturn in farmland values, there have been significant changes in some of the factors that characterize the nature of farm real estate transfers. Among the more notable changes is the decline in the relative frequency in which debt is used to acquire farm real estate, or—stated alternatively—the rise in full equity financing. In a recent report, the USDA indicated that 76 percent of the farm real estate transfers in the year ending February 1 utilized debt financing. That compares to 82 percent the year before and it was well below the peak of 91 percent in 1980. It was also the lowest for any year in over two decades.

The shift toward complete equity financing has been even more pronounced in Corn Belt states which include Illinois, Indiana, and Iowa, as well as Ohio and Missouri. In the year ending February 1, debt financing was utilized in 72 percent of the farm real estate transfers in Corn Belt states, down from a peak of 93 percent in the late 1970s and early 1980s. In the Lake states—which include Michigan and Wisconsin as well as Minnesota—debt financing was utilized in 83 percent of the transfers. While still the highest for any geographic region, that was nevertheless down from the peak of 95 percent a few years ago.

Among farm real estate transfers utilizing debt financing, the ratio of debt to purchase price of the real estate has held fairly steady nationwide but has slipped somewhat in the Corn Belt and Lake states regions. Nationwide, the ratio of debt to purchase price on debt financed farmland transfers averaged 77 percent in the year-ended February 1, still within the range of 76 to 79 percent that has prevailed the past 10 years. In Corn Belt states, however, the ratio of debt to purchase price dropped to 73 percent last year, down from a peak of 80 percent seven years earlier and the lowest for that region in 15 years. In the Lake states

Percent change in dollar value of "good" farmland

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

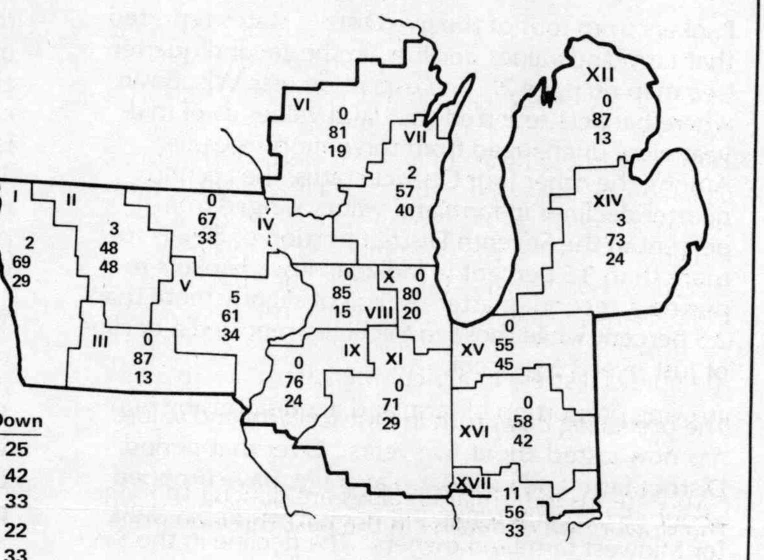


	April 1, 1986 to July 1, 1986	July 1, 1985 to July 1, 1986
Illinois	−1	−11
Indiana	−4	−15
Iowa	−3	−21
Michigan	−2	− 9
Wisconsin	0	−15
Seventh District	−2	−15

* Insufficient response.

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	0	75	25
Indiana	1	57	42
Iowa	2	64	33
Michigan	2	76	22
Wisconsin	1	66	33
Seventh District	1	67	31

region, the ratio dropped to 77 percent last year compared to a high of 83 percent 5 years earlier.

While the ratio of debt to purchase price has held fairly steady nationwide, there has been a pronounced shift in the relative importance of lenders that provide financing for farm real estate transfers. The biggest change has been the role played by commercial banks, particularly in Corn Belt states. Nationwide, commercial banks provided 21 percent of the credit extended by all lenders to finance farmland transfers in the year ended February 1. That was up from 13 percent the year before and well above the range of 4 to 11 percent for banks during the 10 years prior to last year. The surge moved banks close to the declining share provided by Federal Land Banks. In the year ended February 1, FLBs provided 25 percent of the credit extended to finance farmland transfers nationwide, down from 31 percent the year before and the peak FLB share of 37 percent in the early 1980s. Seller financing—mostly through land contracts—remained the dominant source of credit for financing farmland transfers. But at 32 percent of the total, the share for seller financing was nevertheless down from the more typical range of 36 to 40 percent that prevailed in the late 1970s and early 1980s.

The expanded role of commercial banks in financing farm real estate transfers was evident in most regions of the country and by far the most pronounced in Corn Belt states. In the year ending February 1, commercial banks provided 38 percent of the financing for farm real estate transfers in Corn Belt states. That was more than the share for any other lender and more than double the recent high of 16 percent for banks the year before. Individual sellers retained a second place ranking with 30 percent, up from an unusually low share of 27 percent the year before. The share of financing provided by Federal Land Banks in Corn Belt farmland transfers fell to 16 percent, down from 33 percent the year before.

While there have been several changes in some aspects of recent farmland transfers, it appears that farmland buyers continue to be dominated by farmers. Nationwide, farmers—including tenant farmers, owner-operators, and retired farmers—accounted for 75 percent of the farmland acreage that changed hands in the year ending February 1, consistent with the previous 6-year range of 69 to 78 percent and up slightly from the range of 64 to 67 percent that prevailed in the late 1970s. In Corn Belt and Lake states regions, however, it does appear that there has been a slight increase in the proportion of farmland acquired by nonfarmers. But overall, the consistency in the nationwide share of farmland transfers acquired by farmers is contrary to an often expressed view that the financial stress in agriculture is resulting in a growing proportion of farmland acquisitions by nonfarmers.

Future trends in farmland values are difficult to judge. The slower rate of decline in the past three quarters has further raised hopes that the downtrend in land values has about bottomed out. This view has been reinforced by declines in interest rates and crop production costs and by extremely large government farm support payments this year and likely over the next couple of years. Together, these factors tend to offer relatively favorable returns to farmland ownership over the near term. Yet the strength in demand for acquiring farmland may well have been shaken somewhat by the sharp decline in crop prices the past couple of months. In addition, continuing efforts to reduce the federal budget deficit and the effect of those efforts on government support programs for agriculture add to the uncertainties of potential land buyers. Also it would appear that there is a substantial backlog of land available for sale among severely stressed farmers and lenders who have acquired an inventory of farmland through defaults that could push farmland prices still lower. Regardless of these developments, a large majority—67 percent—of the bankers who responded to the most recent survey anticipate that land values will stabilize in the current quarter. The bulk of the remainder, however, expect further declines.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(1977=100)*	July	124	2.5	-2	-14
Crops *(1977=100)*	July	105	-3.7	-13	-27
Corn *($per bu.)*	July	1.99	-14.2	-23	-40
Oats *($per bu.)*	July	.92	-16.4	-30	-46
Soybeans *($per bu.)*	July	5.07	-2.3	-6	-27
Wheat *($per bu.)*	July	2.29	-7.7	-22	-30
Livestock and products *(1977=100)*	July	142	6.8	9	-2
Barrows and gilts *($per cwt.)*	July	59.60	11.0	27	11
Steers and heifers *($per cwt.)*	July	56.10	5.6	5	-10
Milk *($per cwt.)*	July	11.90	0.0	-2	-8
Eggs *(¢per doz.)*	July	58.6	16.0	11	-3
Prices paid by farmers *(1977=100)*	July	161	0.0†	-1	-2
Production items	July	145	-0.7†	-3	-6
Feed	July	107	-5.3†	-7	-22
Feeder livestock	July	154	4.8†	5	3
Fuels and energy	July	155	-3.1†	-24	-23
Producer Prices *(1967=100)*	June	289	0.0	-2	-1
Agricultural machinery and equipment	June	340	0.1	0	1
Fertilizer materials	June	215	-0.6	-7	-10
Agricultural chemicals	June	472	0.9	3	5
Consumer prices *(1967=100)*	June	328	0.5	2	6
Food	June	317	0.0	3	5
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	4,989	N.A.	76	133
Soybean stocks *(mil. bu.)*	June 1	847	N.A.	39	79
Beef production *(bil. lbs.)*	June	2.03	-3.9	7	2
Pork production *(bil. lbs.)*	June	1.07	-12.0	5	-8
Milk production *(bil. lbs.)*††	June	10.8	-3.7	2	9

N.A. Not applicable

†Prior period is three months earlier.

††21 selected states.

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