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FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

ISSN 0002 - 1512

July 25, 1980 Number 1530

DISTRICT FARMLAND VALUES continued to drift lower during the second quarter. A July 1 survey of about 550 agricultural banks in the Chicago Federal Reserve District shows that the value of good farmland declined an average of 2.2 percent during the three months ending in June. The recent decline follows a downturn of similar magnitude in the first quarter. Even so, district farmland values are still 3 percent higher than the year before.

Land values in four of the five district states declined during the second quarter (see back of **Letter**). Michigan was the exception, with bankers in that state reporting an increase of 1 percent. Bankers in Iowa reported the largest decline (down 4 percent), culminating an 8 percent decline in that state since the first of the year. Land values in Wisconsin, which was the only district state to show an increase in the first quarter, declined nearly 3 percent. Bankers in the district portions of Illinois and Indiana reported second-quarter declines of 1 and 2 percent, respectively. Since the end of last year, land values in Illinois and Indiana have declined 4 percent.

The 4 percent decline in district farmland values in the first two quarters is unprecedented by the standards of the 1960s and 1970s. But compared to the rapid escalation in land values during the 1970s, the first-half decline is fairly nominal. District farmland values, on average, are still nearly 4 times higher than at the beginning of the 1970s. And most observers believe that over the longer-term land will continue to show increases in value in excess of most other assets.

The first-half downturn in district farmland values mostly reflects the impact of low farm earnings and high interest rates on demand for farmland. It was generally expected at the beginning of this year that farm income would fall sharply from the record-tieing level of $33.3 billion in 1979 because of abundant supplies and rapidly escalating production costs. Subsequent developments confirmed these expectations. Recent USDA estimates show that net farm income fell to seasonally adjusted annual rates of $27.6 billion in the first quarter and $20.2 billion in the second quarter. Adjusted for inflation and the decline in farm numbers, these estimates imply the lowest real net earnings per farm in 15 or 20 years.

The low earnings and the first quarter escalation in interest rates tended to undermine buyers interest in purchasing land. The lower earnings implied a cash flow squeeze for most farmers, a loss of equity for some farmers, and a poor short-term operating return on new land purchases. High mortgage rates implied sharply higher debt-servicing costs on new land purchases. And the high market rates of interest earlier this spring offered potential land buyers opportunities for high returns on alternative investments, as well as cost-cutting opportunities for replacing operating debt with equity financing. The impact of these developments on potential farmland buyers is evident in the numerous accounts of the extremely low level of farmland transfers over the past several months.

The near-term outlook for farm land values may be somewhat more optimistic than the developments of the first-half. Although mortgage rates are still high by historical standards, they have trended lower. At mid-year, district agricultural banks were charging an average of 13½ percent on farm real estate loans. That is substantially higher than the 10¾ percent of a year ago but still down from 16¼ percent at the end of the first quarter. And some reports indicate that life insurance companies are now more involved in farm mortgage lending after their activity earlier this year had been curtailed by strong policy loan demand.

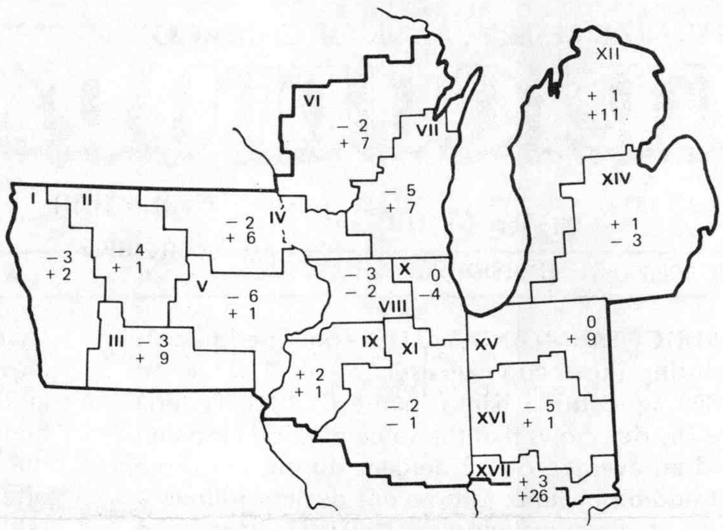
Farm earnings prospects for the second half, although not optimistic when compared to a year ago, point to a better outturn than in the second quarter. These prospects have been greatly reinforced by the recent weather-related surge in crop prices, although much of the recent gains in crop prices might prove to be temporary if weather conditions improve. Irregardless, it would seem likely that an improved farm earnings picture might add some firmness to land values.

Despite the likelihood of better earnings and improvements in mortgage markets, bankers expectations for the third quarter point to further declines in land values. Nearly three-fourths of the bankers that responded to the recent survey expected land values to stabilize in the third quarter. Of the remaining bankers, however, those expecting a further decline in land values exceeded those expecting an increase by a 3 to 1 margin. These results paint a fairly pessimistic picture, although not nearly as bleak as in an April 1 survey. At that time, nearly half the bankers projected a second-quarter decline in land values and only 4 percent projected an increase.

Gary L. Benjamin

Percent change in dollar value of "good" farmland

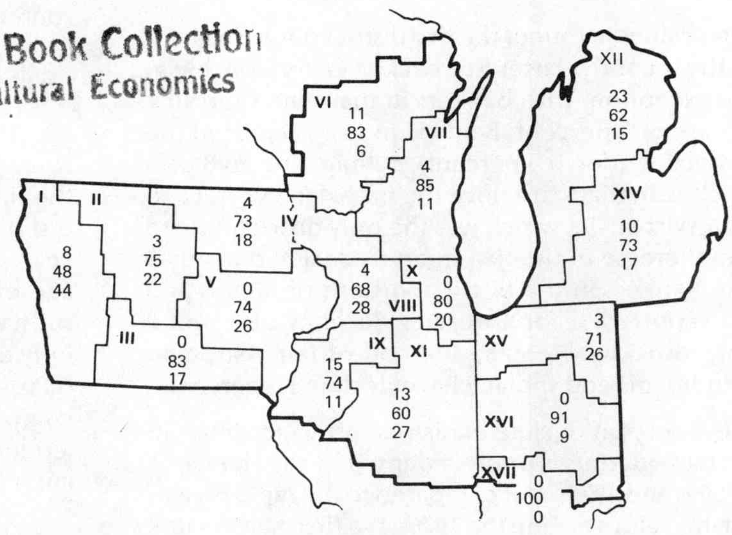
Top: April 1, 1980 to July 1, 1980
Bottom: July 1, 1979 to July 1, 1980



	April 1, 1980 to July 1, 1980	July 1, 1979 to July 1, 1980
Illinois	− 1	− 1
Indiana	− 2	+ 7
Iowa	− 4	+ 3
Michigan	+ 1	+ 2
Wisconsin	− 3	+ 7
Seventh District	− 2	+ 3

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	11	66	23
Indiana	1	85	14
Iowa	4	66	29
Michigan	13	71	16
Wisconsin	8	83	9
Seventh District	7	73	20

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