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Financing the Next Generation of Farmland Owners

by:
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Credit does not appear to play a major role in farm real estate transfers. Lenders provided only 43 percent of the capital used to buy farmland in 1999. The use of credit was less important among farms with less than \$50,000 in sales and among nonoperator landlords. These two groups accounted for 80 percent of all buyers, but only about half utilized credit to fund the land purchase. On the other hand, farmers with over \$50,000 in annual sales were highly reliant on lenders, utilizing credit on over 70 percent of their

land purchases. For many in this group, the availability of credit may be essential in enabling the purchase of land.

The increasing age of farmers and farmland owners is an important issue facing American agriculture. With nearly 40 percent of all farmland owners over the age of 65, there is likely to be a major change in the structure of U.S. farmland ownership in upcoming years (USDA, Agricultural Economics Land Ownership Survey). There is a growing concern in farm country as to who will comprise the next generation of farm operators and landowners. Will the greater availability of farmland perhaps encourage the entry of more part-time farmers, resulting in rural America being a patchwork of small farms and rural residences? Or, will the greater availability of farmland result in more acquisitions by large commercial farms and wealthy nonfarm investors, resulting in a rural America dominated by the large landowners?

Through their credit policies, lenders may have an influence on who will be the next generation of farmland owners. For many, such as young or beginning farmers or those with limited financial resources, access to

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credit will be essential in enabling the purchase of farmland.

This article examines changes currently unfolding in farmland markets and what influence lenders may have on the farmland transfers. Data used in the analysis was obtained from the 1999 Agricultural Economics Land Ownership Survey (AELOS). The approach used is to analyze changes in land ownership among uniform groups of landowners. For purposes of analysis, landowners were divided into four major groups and 13 mutually exclusive sub-groups described in table 1 on page 38.

An examination of land ownership among the four major groups indicates that many farmland owners are not significantly engaged in the production of farm commodities. Small farms and nonoperator landlords comprised 88 percent of all landowners and owned 75 percent of all farmland. Family and commercial farms represented only 12 percent of landowners and owned 25 percent of farmland, but accounted for 90 percent of farm production (USDA, AELOS).

The net percent change in farmland ownership for each landowner group was used to make comparisons of farmland ownership changes that occurred in 1999 among the 13 groups of landowners.¹ The general expectation was

that younger landowners and those with the greater financial resources would show the greatest percentage changes in farmland ownership.

Land Ownership

by Small Farms Expanding

Lifestyle and part-time farmers expanded their farmland by 3.1 and 4.1 percent, respectively, in 1999 (table 2, line 5). If this trend continues, the amount of land owned by these groups could double over the next 20 years. As would be expected, those small farms where the owner/operator had lower financial resources or where the operator was over 65 years of age did not notably expand their farmland under ownership in 1999.

The small farmer's ability to purchase land did not appear to be influenced by either returns to farming or by credit availability. Lifestyle and part-time farmland buyers lost, on average, over \$10,000 from farming in 1999. However, their average household income, which included nonfarm income, exceeded \$100,000. Also, the average value of the operator dwelling exceeded \$100,000, a value that would be considered well above average, especially for rural America. These attributes would make them an attractive low-risk group to lenders. But the capability of lifestyle or part-time farmers to purchase land does not appear to be influenced very much by credit availability. Fewer than half of these buyers utilized credit to fund their farmland purchases (table 2, line 6). Among those who

¹ The net percentage change in farmland ownership was estimated as:

$$\frac{((\text{Acres bought in 1999 less acres sold in 1999}) / (\text{Acres owned at the end of 1999})) * 100}{}$$

A more correct estimate would have included acres owned at the beginning of 1999 rather than the end of 1999. But these data were not available in the AELOS because it is not an annual survey.

Table 1. Descriptions of Landowner Groups Used in the Study

<i>Major Group</i>	<i>Sub-Group</i>	<i>Definition</i>
Small Farms/ Under 66 years of age	Lifestyle	Above-average income, annual farm sales <\$5,000, primary occupation is farming.
	Part time farmer	Annual farm sales <\$50,000, above average household income and net worth >\$100,000, and not previously defined as a lifestyle farmer
	Limited resource	Annual sales <\$50,000, household income below the county average or or net worth <\$100,000, and not previously defined as a lifestyle farmer
Small farms/ over 66 years of age	Retired	Annual sales <\$50,000 and operator >66
Family Farms	Younger, lower equity	\$50,000 < annual sales < \$250,000; net worth >\$500,000; operator age <46
	Younger, higher equity	\$50,000 annual sales <\$250,000; net worth >\$500,000; operator age <46
	Older	\$50,000 < annual sales <\$250,000; operator age >46
Commercial farmers	Younger, lower equity	Annual sales >\$250,000; net worth <\$1,000,000; operator age <46
	Younger, higher equity	Annual sales >\$250,000; net worth >\$1,000,000; operator age <46
	Older	Annual sales >\$250,000, operator age <46
Landlords	Absentee	Owned acres <200% of county average farm size, landlord resides 50 miles or more from farm
	Resident	Owned acres <200% of county average farm size, landlord resides within 50 miles of farm
	Land baron	Owned acres >200% of county average farm size

Table 2 Selected Land Ownership Statistics for Farm Operator Landowners for 1999

	Farms with Annual Sales < \$50,000				Family farms			Commercial farms			All Farm Operator land-owners
	Life-style	Part-time farmer	Limited resource	Retired	Younger lower equity	Younger higher equity	Older	Younger lower equity	Younger higher equity	Older	
(Totals)											
Landowners	412,638	165,729	247,152	594,218	72,233	33,327	194,552	35,017	15,562	88,761	1,770,428
Landowners buying land	22,113	6,080	9,818	17,227	5,250	2,549	8,874	2,086	1,508	5,718	75,505
(Dollars)											
Average new loan size (\$thousands)\1	56.1	94.9	53.9	81.2	81.2	113.0	135.8	102.7	138.2	297.6	83.0
Total new mortgage debt to buy land (millions) \2	581	288	355	674	364	231	779	172	149	1,116	3,593
(Percent)											
Net change in land owned \3	3.1	4.1	-0.4	0.5	6.6	1.7	1.2	2.9	1.1	0.7	1.7
Share using credit	46.8	49.9	67.1	48.2	85.4	80.0	64.7	80.4	71.3	65.6	57.3
Loan-to-value\4	58.2	70.3	78.2	60.0	79.1	73.6	68.0	81.7	78.2	69.8	67.7
Debt market shares\5											
FCS	8	34	7	39	6	32	18	18	28	33	20
Banks	47	29	67	34	67	46	44	58	49	42	47
FSA \6	D	D	3	D	10	11	3	1	2	3	3

1\ Average amount of land purchase financed for farms using credit. 2\ Equal to average new loan size * Number of landowners buying land using credit. 3\ ((Acres bought in 1999 - acres sold in 1999)/ acres owned at year-end 1999) * 100. 4\ Loan to value of land purchased. AELOS did not capture information on any other property that may have been offered as security. 5 \ Based on total debt outstanding for farms buying land in 1999. 6\ FSA direct loans only.
D= Insufficient data for disclosure.

Among lifestyle farmers, FCS provided only 8 percent of credit and only 7 percent for those with limited resources.

used credit to finance their farmland purchase, the cash down payments averaged 40 percent for lifestyle farmers and 30 percent for part-time farmers (table 2, line 7). The limited use of credit suggests that their capability to buy land was not affected as much by credit availability as by the availability of wealth that can be utilized to fund land purchases.

Operators of small farms represented a substantial amount of demand for new mortgage debt in 1999. Small farms represented about a fourth of the volume and 43 percent of the number of farm mortgages used to fund farm real estate purchases. The total dollar amount of loans used to purchase farmland by small farms was about \$1.9 billion in 1999. Commercial banks meet a large share of the credit needs of each small farm group ranging from a 67 percent market share for the limited resource group to 29 percent for part-time farmers (table 2, lines 8-9).

Institutions of the Farm Credit System (FCS) appeared to be primary sources of credit for the part-time and retired small farmers, with banks being the primary source to lifestyle and limited resource farmers buying land (table 2). Among lifestyle farmers, FCS provided only 8 percent of credit and only 7 percent for those with limited resources.

Efforts to increase lending among small farms may meet with only limited success. While lenders may find lending to small farms attractive, these markets are likely to be highly competitive. The high household incomes, which were derived mostly from nonfarm income sources, combined with the relatively high values for the operator dwelling, suggest that these individuals are in less need of a farm loan than a traditional home mortgage loan where repayment would be based on monthly payments. Many lenders, regardless of their expertise in rural lending, could easily provide such a product.

It may be possible that some creditworthy small farmers are missing out on opportunities to buy farmland because of limited access to credit. Such may be the case for the limited resource group for whom the amount of farmland owned declined in 1999 by 0.4 percent (table 2).

But even if credit were more readily available to these farms, it is not clear that they would expand their farmland ownership. By themselves, most small farms simply do not generate enough income to support debt repayment. Therefore, potential small-farm buyers need sufficient financial resources, in the form of either wealth or non-farm income, to sustain the farming losses that are likely to occur.

Family and Commercial Farmland Buyers Highly Reliant on Credit

Both the family and the commercial farm groups increased their farmland ownership in 1999 (table 2, line 5). These full-time farmers were much more reliant on credit in their farmland purchases than either small farms or nonoperator landlords. Over 70 percent of family and commercial farmers utilized credit in the purchase of farmland generating \$2.8 billion in new loan volume in 1999. Most loans made to family farms to buy farmland were in the \$50,000 to \$200,000 range. Among commercial size farms, most loans to buy farmland were less than \$400,000. This should not be surprising given that it would be difficult for many family and commercial size farms

to support greater amounts of debt.

Commercial banks were an important source of credit to all groups of family and commercial-size farms (table 2, line 9). The FCS has been a more important credit source to older buyers and those with greater net worth. Among younger, lower-equity family farmers who purchased land, FCS's market share was only 6 percent. These results, combined with the FCS's low market shares for limited resource small farms, suggest that FCS lenders are more risk averse than commercial banks. It does not appear, however, that FCS curtails lending to all younger farmland buyers. They were an important source of credit to those younger farmland buyers with stronger balance sheets. Among higher-equity family and commercial-size farmers, FCS's market share was 32 and 28 percent, respectively (table 2, line 8).

Also, it does not appear the apparent unavailability of credit from FCS hampered younger, lower-equity farmers in their efforts to acquire land. Younger, lower-equity family farmers still reported an increase in farmland owned of 6.6 percent (table 2, line 5). They did so by relying heavily on credit provided mostly by commercial banks and USDA's Farm Service Agency. Over 85 percent of this group used credit to fund the land purchase, with most making cash down payments of less than 15 percent (table 2, lines 6-7). Regardless of their equity, over 70 percent of younger farmers utilized credit to fund their farmland

purchases.

Nonoperator Landlord Farmland Ownership Declining

While most groups of farmers increased their land ownership in 1999, land ownership among nonoperator landlords declined (table 3, line 5). Resident landlords and land barons reported a decline of 2 million acres under their ownership. Also, younger investors do not appear to be buying land. Of the nonoperator landlords who purchased land in 1999, 85 percent were over 55. Since the 2 million acre decline in farmland owned represents less than a 1 percent change in land owned by this group, nonoperator landlords will likely remain a major landowner group for the foreseeable future.

Still, the data do suggest that a shift in land ownership from landlords to farmers may be under way. While there are positive aspects to farmers owning rather than renting their land, a declining interest in acquiring land among nonoperator landlords also can have negative impacts. By accounting for 28

Table 3 Land Ownership Statistics of Non-operator Landlords in 1999

	Non-operator landlords			All non-operator landlords
	Absentee	Resident	Land baron	
(Total)				
Landowners	1,019,462	886,684	87,875	1,994,021
Landowners buying land	23,473	20,141	3,947	47,561
(Dollars)				
Average new loan size (\$ thousands)\1	161.9	178.3	287.1	178.9
Total new mortgage debt to buy land (\$ millions)\2	1,486	1,246	423	3,155
(Percent)				
Net change in land owned\3	0.4	-0.7	-0.6	-0.4
Share using credit	39.1	34.7	37.3	37.1
Loan-to-value\4	77	69.1	63.8	64
Debt market share\5				
FCS	5	26	38	19
Banks	76	51	34	57

See footnotes on table 2.

Source: 1999 USDA Agricultural Economic and Land Ownership Survey

See footnotes on table 2.

Source: 1999 USDA Agricultural Economic and Land Ownership Survey

percent of all buyers in 1999, landlords add liquidity to farmland markets. Landlords also supply much of the capital used by commercial farms. Through leasing, farm operators have been able to utilize greater operating leverage, spreading their fixed capital cost over a greater number of acres. A reduction in land available through leasing arrangements could have the adverse effect of limiting opportunities for young and beginning farmers who rely more heavily on land leasing.

Thus, there may be benefits to encouraging greater participation by nonfarm investors (nonoperator landlords) in farmland markets. However, it is unlikely that changes in lending policies of either public or private lenders would have any impact on the ability of such investors to purchase land. Landlords are simply not very reliant on credit when purchasing farmland. Only 37.1 percent utilized credit, and for those who did, the down payment averaged over 35 percent, compared to an average down payment of 22 percent for family and commercial farms. Like many small farm buyers, landlords' decision to buy farmland may be driven by their own levels of wealth and not credit availability.

It may be prudent, nonetheless, for lenders not to ignore this group of landowners. Although they are less reliant on credit, landlords may generate substantial loan volume. Purchases by nonoperator landlords represented nearly half of the value of farmland purchased in 1999. The total amount of mortgage debt demanded by this group for land

purchases, \$3.16 billion, exceeded that for small or full-time farmers and represented 42 percent of the dollar volume of loans used to purchase land in 1999 (table 3, line 4).

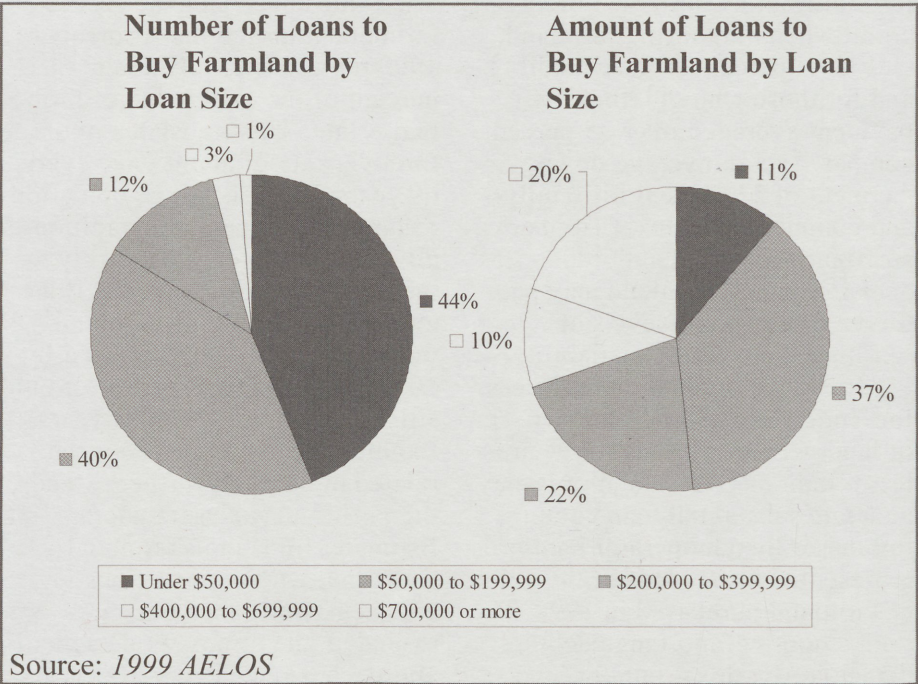
Lender Volume Growth Through New Mortgages Is Limited

The potential for a large volume of farm transfers in upcoming years would suggest that farm mortgage lenders should benefit from increased loan volume. But changes in farmland ownership occur slowly. While lenders are likely to see an increase in demand for mortgage credit to finance new land purchases, a boom is unlikely. The demand for mortgages used to buy farmland is limited by the slow turnover rate for agricultural land. The value underlying the 125,000 farmland transactions occurring in 1999 represented only about 1.6 percent of the total value of farm real estate. This translates into a turnover rate of about once every 60 years. With an aging population of farmland owners, the traditionally slow turnover rate is likely to increase in upcoming years. But even if the amount of farmland transferred per year increased by 20 percent, the turnover rate would still be only once every 52 years. Excluding transactions between related individuals further extends the period between transfers. Estimates for Illinois farmland show that when transactions between family members are excluded, the turnover rate actually approaches once every 100 years.

Potential buyers may still have to wait a long time if they want to purchase a specific farmland tract.

The limited use of credit by farmland buyers limits potential growth of mortgage loan volume. Only 43 percent of the value of farmland purchased was financed with loans that resulted in \$6.7 billion in new mortgage loans in 1999. Plus, mortgage volume was heavily concentrated among a few large transactions. If mortgage volume continues to be concentrated, competition for these loans among lenders is likely to be keen. Mortgages over \$700,000, or 1 percent of all mortgages, accounted for 20 percent of the mortgage loan volume used in the purchase of farmland (figure 1). While these large mortgages accounted for most loan volume, smaller mortgages accounted for a large share of the total number of purchase mortgages. Mortgages under \$50,000, for which lenders typically receive limited profits, accounted for

Figure 1. Distribution of Loans Used to Purchase Farmland in 1999 by Size of Loan



Source: 1999 AELOS

44 percent of the number of all mortgages used to buy farmland but only 11 percent of the volume.

Summary

There is a growing appetite for land among the lifestyle and part-time farming groups. This reflects the growing demand for farmland by those desiring a country lifestyle and having income or wealth from nonfarm sources. While the presence of these groups is increasing, it is unlikely that these groups of landowners will be predominant in rural America in the foreseeable future. Land turnover rates are simply too low to allow any great expansion by any group of landowners. The high incomes and wealth associated with lifestyle and part-time farmers would make them attractive prospects for lenders. Consequently, lenders are likely to continue to develop loan products targeted toward this segment of the farm population. This is evident among the Farm Credit System, where nearly every FCS association website advertises programs targeted toward country home, lifestyle, and part-time farmers. But the greater availability of credit should have little impact on the ability of lifestyle and part-time farmers to purchase land. Most of their land purchases were cash deals, and those where credit was used, the down payment was high.

While lifestyle and part-time farmers were increasing their holdings of land, non-operator landlords' ownership of land was declining. As with part-time and lifestyle farmers, it is unlikely that

lenders have any impact on nonoperator landlords ability to purchase land. Only 37 percent of non-operator landlords reported any use of credit to buy land in 1999. The ability of both nonoperator landlords and small farmers to purchase farmland appears influenced more by the availability of wealth than either farming returns or credit availability. Commercial lenders will still need to heed these groups, as they will still represent a large share of potential new mortgage loan volume.

Among family and commercial farms, policies of federal credit programs and procedures followed by commercial lenders are more likely to have an influence on the ability to buy land. Over 70 percent of family and commercial-size farms buying land utilized credit, and when credit was used, down payments were relatively low. Federal and state credit programs, such as those provided through USDA's Farm Service Agency, are likely to be important in enabling operators of family and commercial size farms to purchase farmland. It will be important that there are sufficient funds available in federal and state credit programs to finance land purchases by creditworthy younger operators of family and commercial size farms. By themselves, credit policies, however, are likely to be much less important in enabling family farmers to buy farmland than the continuation of government payments and the existence of strong balance sheets. **jal**

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