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PAY DIRT

Farmland as Investment

By Charles E. Gilliland

Price trends for cropland have traditionally followed farming profitability. As prices for commodities such as corn and wheat escalate, investors take advantage of those increasing prices by purchasing farmland.

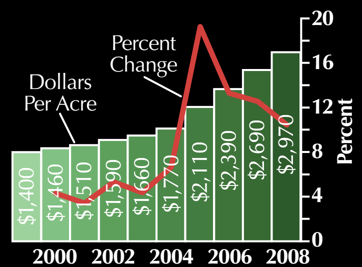
While recreational buyers still dominate many rural land markets, the number of farmers and investors looking for agricultural land grew substantially at the end of 2007 and throughout most of 2008. In fact, these buyers have prompted price increases in farming areas across the nation for several years. Current market participants indicate agricultural-minded buyers are still interested but the financial crises in the economy may be slowing purchases.

U.S. Department of Agriculture (USDA) studies indicate that average U.S. cropland values have increased dramatically for the past four years, posting annual gains exceeding 10 percent each year and climbing an astonishing 19 percent from 2004 to 2005 (Figure 1). Although the rate of increase is slowing, the 10.4 percent growth in 2008 represents a sizable gain in an otherwise difficult year.

Cash rents for cropland followed a similar pattern, rising gradually from 1999 through 2006 (Figure 2). They skyrocketed in 2007 and 2008 as commodity prices soared to new highs. Rents reached an average of $96 per acre before commodity prices retreated in fall 2008.

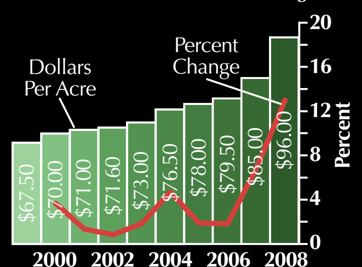
Lying between Lubbock and Plainview, the South Plains land market area is predominantly farmland. Land prices in this area followed a pattern remarkably similar to the USDA cropland prices. The rise from $501 per acre in 2004 to $858 per acre in 2008 coincided with the run-up in crop lease rates (Figure 3).

Figure 1. U.S. Average Cropland Value
Price and Annual Percent Change



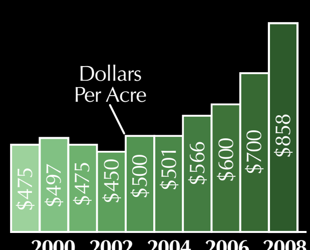
Source: U.S. Department of Agriculture, National Agricultural Statistics Service

Figure 2. U.S. Average Cropland Rents
Cash Rents and Annual Percent Change



Source: U.S. Department of Agriculture, National Agricultural Statistics Service

Figure 3. Texas South Plains Rural Land Prices



Source: Real Estate Center at Texas A&M University

As long as commodity prices climb faster than input costs, demand for farmland will expand. However, the decrease in commodity prices after the July 2008 peak may leave many farmers at risk of sustaining losses at harvest.

Investors who helped propel prices higher appear to have abandoned the market during the last quarter of 2008. However, some investors remain bullish on a return of high commodity prices. In 2009, they argue, some producers may find production loan capital difficult to obtain. The ensuing debt squeeze, a fallout from the financial market freeze, will reduce the amount of acreage planted.

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In addition, high costs may cause farmers to use less fertilizer, further contracting historically low stocks. Corn, wheat and soybean prices could rebound at midyear as a decrease in output becomes a reality. Farmers who can harvest a crop may well realize expanded net profits.

Many observers believe that along with enhanced profitability, massive government emergency spending will lead to hyperinflation. According to them, holding tangible assets like land provides protection from a sinking currency. Now is the time, the thinking goes, to position capital in land.

Further, sizable pools of investment cash are reportedly waiting on the sidelines for safe, lucrative investments. Anticipated inflation along with uncertain international political conditions may bring investors back to the farmland market. These forces could pump up farmland values.

Other observers foresee waning demand on a broad basis. They see commodity markets hit by falling incomes and a resulting inability to fund commodity purchases. In addition to declining effective demand, rising prices from falling production suggest that some land will lie fallow. Foreclosures of those properties may ensue, resulting in a growing inventory of lender-acquired properties. Farmland prices could suffer under these conditions.

These are all reasonable conjectures given the current political and economic environment. In such an atmosphere, what lies ahead for the nation's farmland markets?

Ultimately, these factors translate into an atmosphere more fraught with uncertainty than at any other time in the past two decades. A real threat exists for significant economic damage ahead that is unlikely to bypass agriculture if job losses spread.

Current market participants indicate that demand for nonfarm rural land has cooled significantly. Farmland sales have reportedly shown signs of stress, including auctions producing unsatisfactory bids and institutional investors canceling deals. Many have adopted a wait-and-see attitude.

Taken together, these factors point to the possibility that prices could stagnate or possibly even reverse past progress. That threatens a potential long-term correction in land markets. Still, land has historically been a stable investment in economically uncertain times.

Dr. Gilliland (c-gilliland@tamu.edu) is a research economist with the Real Estate Center at Texas A&M University.

THE TAKEAWAY

Continuing economic uncertainty is prompting some investors to purchase farmland as an investment. Cropland prices and rents have increased steadily since 2004, in part because of rising commodity prices. But the 2008 run-up and subsequent collapse in commodity prices have caused other investors to rethink their strategies.

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Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
979-845-2031

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