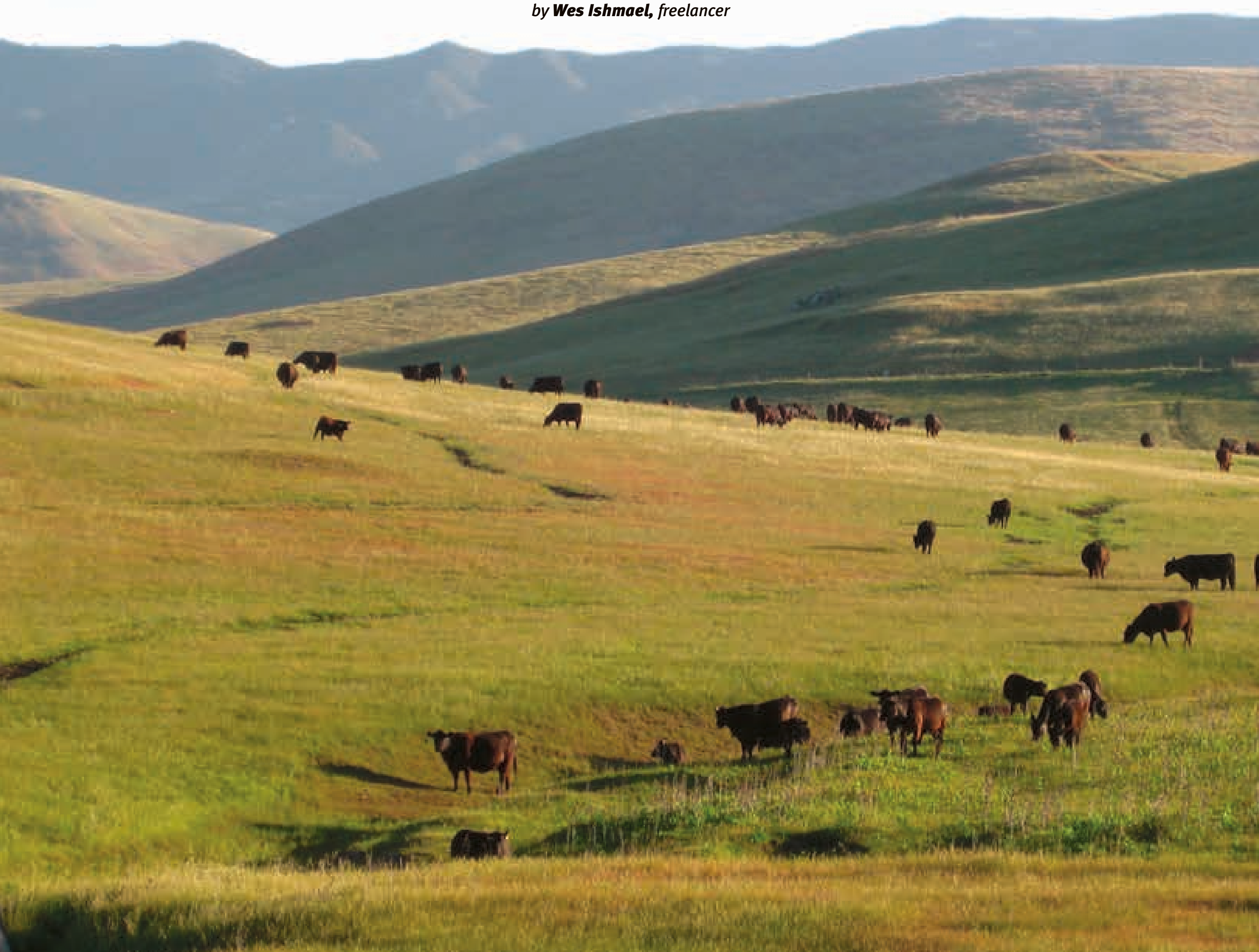
Higher and Higher

Although agricultural land values show recent signs of softening, increased competition makes continued strength hard to bet against.

by ***Wes Ishmael,*** *freelancer*



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35 Keys to Success

Securing a Land Resource

Anyone hoping for a crash in agricultural land values in order to buy a stake in the cattle business (see "No Cheap Tickets," page 92) may be waiting for a while.

Demand for farmland remains strong, and recent land prices are fundamentally sound even after several years of surging prices, according to R.D. Schrader, president of Schrader Real Estate and Auction Co. at Columbia City, Ind. He explains farmland values were higher year-over-year for all but one of the past 26 years.

In offering a series of updates to farmers, farmland investors and bankers this spring, Schrader reviewed data from a variety of sources, including the Chicago Federal Reserve Bank, the National Agricultural Statistics Service, Purdue University and Iowa State University. While some states and time periods were weaker than others, the data indicate the overall upward trend for agricultural land value continues.

"When it comes to buying land, you cannot spend too much time researching all of the contingencies."

— John Blanchfield

Windfall returns from grain farming fueled at least part of the surge in recent years as farmers reinvested dollars. According to the American Bankers Association (ABA) Agricultural and Rural Bankers Committee, the increase in crop and livestock prices has generated significant profits for many farmers, which some are using to buy additional land. Growing demand has driven land values to record highs in many areas.

With grain prices in mind, land prices appear to be softening in some areas, with expectations of lower crop profits for the new crop year, following the downturn in the last one.

In their first-quarter Survey of Tenth District Agricultural Credit Conditions, analysts with the Federal Reserve Bank of Kansas City (KCFRB) note the value of non-irrigated farmland declined 1.4% compared to the fourth quarter of last year.

The value of irrigated farmland rose 0.5%.

The Tenth District includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern one-half of New Mexico and the western one-third of Missouri.

"In contrast, strong demand for high-quality grazing pastures bolstered ranchland values, which increased 2.6% from the fourth quarter of 2013," KCFRB analysts say. "In keeping with these trends, some bankers expected additional easing in cropland values in the next three months but felt that ranchland values could strengthen further."

"America's farms are on a solid footing. Farmers, the operators, have been driving this market. It wasn't 100% financing that got us here. Debt-to-equity ratios are in a 10%-13% range — as low as they've been in the last 50 years," Schrader explains. "Volatile corn prices, especially, have been a concern, with current prices very close to the breakeven point for many farmers. While some operators may struggle with income fluctuations, the industry as a whole remains strong. The dynamics today differ starkly from those of the 1970s leading into the 1980s."

If you were around for that economic bloodletting, you know all about the intense leverage and high-teen interest rates that took plenty of folks out of the business, while crippling the long-term balance sheet of others.

So, it's not like the bottom shows signs of collapsing. Besides, as the saying goes, they're not making any more land.

For folks hunting pasture, competition is at least as fierce since less cropland is being used for that purpose, according to results of the *2012 Census of Agriculture* released in May.

Pasture acres declining

"A comparison of the 2012 and *2007 Census of Agriculture* shows that total pasture acreage in the U.S. declined by 3.6%," explained Derrell Peel, Extension livestock marketing specialist at Oklahoma State University in late-spring market comments. "This decrease was due to a 64% decrease in cropland used as pasture. This pasture category decreased significantly in all states; but, since cropland pastured represents a much larger proportion of total pasture in some regions, the impact on total pasture

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►**Left: "A comparison of the 2012 and *2007 Census of Agriculture* shows that total pasture acreage in the U.S. declined by 3.6%," explained Derrell Peel, Extension livestock marketing specialist at Oklahoma State University in late-spring market comments.**

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varied widely across states. In the eastern half of the country, including the Midwest, Great Lakes, Appalachian, Gulf and South regions, pastured cropland, which accounted for 21% of total pastureland in 2007, dropped to less than 7% in 2012."

Overall, Peel explains, there was a 12% decrease in total pasture in the eastern half of the United States vs. a 2% decrease in the Rocky Mountain and Plains regions.

"The implications of regional loss of cropland used as pasture is considerably more than the acreage alone would indicate," Peel says. "The average number of pasture acres per beef cow in the eastern half of the country is less than 5 acres per cow. In the Plains and Rocky Mountain regions, the average is more than 22 acres per cow.

"Although this is a broad measure of stocking rates, it is indicative of the forage productivity in the two regions," he continues. "As a result, while there is only 17% as many pasture acres in the East, the number of cows in the eastern half of the country was 75% of the number of cows in the Plains and Rocky Mountain regions in the 2012 census. This percentage is similar in the 2007 census, but the 2012 census includes the impacts of the drought. Drought recovery at some point is likely to result in herd rebuilding in the West, particularly in the Southern Plains, while the loss of pasture acreage likely means that cow inventories in the East will be permanently reduced."

Decreased supply relative to demand explains part of the reason behind increasing pastureland values, even as the nation's cow herd declined 16 of the past 18 years.

Pasture value per acre increased an average of 10.4% across the United States from 2009 to 2013, according to USDA's *Agricultural Land Values-Final Estimates.*

James McGrann, a noted livestock economist, and owner of Ranch Management Economist, emphasizes land purchase or lease value offer little insight unless they're converted into cost or value per animal production unit, which requires knowing the stocking rate.

"Each land purchase is unique and requires a study of the financial feasibility," McGrann says. "The land market is quite efficient and very competitive as a very small portion of land is sold annually. Demand is not only due to cattle earnings, but there is a large demand for recreation and lifestyle, particularly for small acreages. Land has been a good hedge against inflation."

The average value of farm real estate increased an average of 30.6% during the same period (see Table 1). In 2013, the national average price was $2,730 per acre.

For perspective, the average value of cropland increased 44.3% during the same stretch to a national average of $3,810 per acre in 2013.

"Pastureland has been in short supply in recent years throughout the Midwest primarily due to record-high grain prices and other commodity pressures," Kevin Gould, Extension beef cattle specialist at Michigan State University explained in May. "It appears the trend has peaked for corn and is headed back to a 'new normal' trading range for grain." However, he added, "Pressure may still be on grazing lands in the short term as livestock producers looking to expand or find new grazing opportunities stay competitive in the market and bid pasture prices higher than national averages."

Whether farmers and ranchers use cash or borrow money to purchase land, the folks at ABA say that buying land should include a well-researched financial plan (see "Caution Pays," page ___).

You can find a lot of people who can assist in the process of creating a business plan, appraising land values and what-not, but McGrann stresses that you should work your way through the process before going to a

15 questions to ask before purchasing farmland

No one knows more about financial budgeting and cash-flow planning than your banker, according to the American Bankers Association (ABA) Agricultural and Rural Bankers Committee. Before pulling the trigger on land acquisition, ABA recommends talking with your banker. In the meantime, ABA advises considering the following questions.

What is your business's financial condition? Consider needed investments, expected expenditures and crop conditions to determine if buying land is the best use for your cash. Are there other opportunities that can provide a better return?

Have you created a pro-forma cash flow? Research sales trends and expected revenue of a potential plot of land to determine how well the purchase fits within your plan. Does the potential return meet your objectives? Your banker can help you develop this essential planning tool.

James McGrann emphasizes doing the research and developing the necessary reports and plans before approaching a lender.

Given your revenue forecast, are you overpaying? If you are paying a premium, how long will it take you to recoup? Determine how much your business should prudently spend on a land purchase and the revenue needed to justify your purchase and stay within those targets.

Have you thought long and hard about it? Never be rushed by a broker and never confide your best price or financial goals with a party working for the seller. Don't buy impulsively or make a deal before visiting the property numerous times. Rework the standard broker's purchase contract with your lawyer, deleting what you don't like and adding what you want, before presenting the offer.

Does it make more financial sense to rent the land rather than own it? Rental rates are high, but renting frees your cash for other activities. What will be your total land payment per tillable acre owned, and how does this compare to cash rents in your area?

Should you go all in with your cash? Talk to your banker about alternatives to using all cash in the transaction. Land is an illiquid asset, and purchasing it will impact your farm's liquidity. Your banker can work with you to structure a loan that will enable you to acquire the land you need while preserving some of your working capital for necessary expenditures.

How much land are you acquiring? Sounds simple, but many times there is confusion about how much land is actually being purchased. Know exactly what you're getting before making a bid. See if the land has been surveyed, and make sure it matches the details of the offer. If the land has not been surveyed, work with your attorney to determine the acreage based on the legal description, or consider having the land surveyed, and determine who will pay for it. Make sure that there are no special easements tied to the land. If there are, make sure you spend time studying them and understanding them completely.

What does the land appraise for? Are there some comparable sales in the area? Appraisals are expensive, but they are the best way to establish value. Even if you do not get a full appraisal, attempt to find some comparable sales to determine if the purchase price is reasonable.

lender. If the plan doesn't work on paper for you, there's little chance that it will or should entice someone else to throw the dice with you.

"When it comes to buying land, you cannot spend too much time researching all of the contingencies," says John Blanchfield, ABA senior vice president of agricultural and rural banking.

Especially considering current market conditions, ABA developed a list of recommendations to consider before purchasing agricultural land (see "15 questions to ask before purchasing farmland," page 104).

One more thing when considering agricultural land these days, according to Schrader: "The big elephant in the room, as far as demand (land) goes, is these world populations and rising incomes."

By now, you know population estimates suggest the global food supply must double by 2050.

AJ

Editor's Note: *Wes Ishmael is a freelance writer from Benbrook, Texas.*

Table 1: Farm real-estate value per acre, $

Region	2009	2010	2011	2012	2013
United States*	2,090	2,150	2,300	2,520	2,730
Northeast[1]	4,810	4,690	4,690	4,790	4,850
Lake States[2]	3,240	3,220	3,450	3,880	4,240
Corn Belt[3]	3,550	3,830	4,460	5,190	5,880
Northern Plains[4]	1,000	1,080	1,290	1,620	1,960
Appalachian[5]	3,490	3,480	3,520	3,530	3,610
Southeast[6]	3,750	3,630	3,610	3,530	3,590
Delta[7]	2,140	2,210	2,300	2,440	2,520
Southern Plains[8]	1,450	1,520	1,580	1,620	1,630
Mountain[9]	918	902	899	953	1,010
Pacific[10]	3,990	4,070	4,100	4,270	4,290

*48 states.

[1]NJ, NY, PA and New England States.

[2]MI, MN, WI (excludes Indian Reservation land).

[3]IL, IN, IA, MO, OH.

[4]KS, NE, ND, SD.

[5]KY, NC, TN, VA, WV.

[6]AL, FL, GA, SC.

[7]AR, LA, MS.

[8]OK, TX.

[9]AZ, CO, ID, MT, NV, NM, UT, WY.

[10]CA, OR, WA.

PHOTO COURTESY ARS

Source: USDA *Agricultural Land Values-Final Estimates 2009-2013.*

McGrann believes reputable land appraisers are worth every penny when considering the magnitude of the purchase. He also stresses making sure you understand which mineral rights, if any, go with the land.

What is the soil's story? What is the capability of the soil you are buying, and how does this impact your revenue forecast? Good soil is paramount. Know the type of soil you're buying and the history of annual crop rotation. Any seller should be more than happy to provide you with a soil's profile and information about past farming practices.

What is the water source? Is the property irrigated? Do the water rights convey with the property? Adequate water is essential to establishing the value of the property. Account for water cost in your financial plan to ensure this cost doesn't negatively impact your return. Make sure all water wells are registered with the appropriate authorities. Each state has its own water laws so make sure you are familiar with the state that you are doing business in.

What do you know about the gas, mineral and wind rights for the property? Do these rights convey to you as the purchaser? Have they been surveyed or severed from the surface rights? Are they currently under lease? If under lease, what are the terms? Have a thorough knowledge of property rights, as mining and drilling can have an impact on surface and water quality, access to the property, and the viability of the farm or ranch.

How is the property zoned? Will your plans for the property conflict with existing zoning restrictions? Are there conservation easements that could restrict use of the property? This factor has a significant impact on your valuation of the property, particularly if your plans conflict with current zoning restrictions. Make sure that you understand the assured leases that may go with the property. Many of the states in the West have a large percentage of their ground that falls into this category (Bureau of Land Managment, Forest Service, state land, national grassland).

How will you hold deed in the property? Will you own it individually, jointly with a spouse, in a family-owned entity [corporation, limited liability company (LLC), limited-liability partnership (LLP)] or in a trust? The pros and cons of how you own the land will depend on your long-term goals.

Are there any environmental problems? The last thing you want to buy is a costly environmental problem. Paying for an onsite environmental audit before you buy the land may be worth the cost and will help ensure you are not buying into an expensive cleanup.

How long will you actively farm or ranch? Make sure your financing plan matches the rest of your intended career as an active producer. Will you fully retire all debt from the acquisition before you retire? Do you have sufficient life and disability insurance?

If you own land for cattle production that you intend to leave to the next generation, McGrann emphasizes the need to develop an estate plan and develop it soon enough that it can be executed.

Source: The American Bankers Association