Farmland IN PERSPECTIVE

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GOODWIN

Goodwin & Associates Real Estate, L.L.C.

Mark Goodwin
Real Estate Broker

131 Airport Dr. • Unit H
Joliet, IL 60431
(815) 741-2226

A Snapshot of Today's Family Farms

Most U.S. farms are family farms, 98% in 2004. Non-family corporations make up a small and stable share of farm numbers and sales, accounting for less than 1% of farms and 6-7% of farm product sales in each agricultural census since 1978.

- Small family farms account for most U.S. farms and farm assets. Family farms with sales of less than $250,000 accounted for 90% of U.S. farms in 2004, according to the Economic Research Service (ERS) of the U.S. Dept. of Agriculture (USDA). They hold about 68% of all farm assets, including 61% of the land owned by farms, and account for 82% of the land enrolled by farmers in the Conservation Reserve and Wetlands Reserve Programs (CRP and WRP).
- Large-scale family farms and non-family farms produce the largest share of agricultural output. They made up 10% of U.S. farms in 2004, but accounted for 75% of the value of production.
- The number of large farms is growing. The number of farms with sales of $250,000 or more grew steadily between the 1982

Continued on page 3

Why Farmland Leases May Change As Commodity Prices Increase

by Gary Schnitkey, Ph.D. • Professor and Farm Management Specialist Department of Ag Economics • University of Illinois

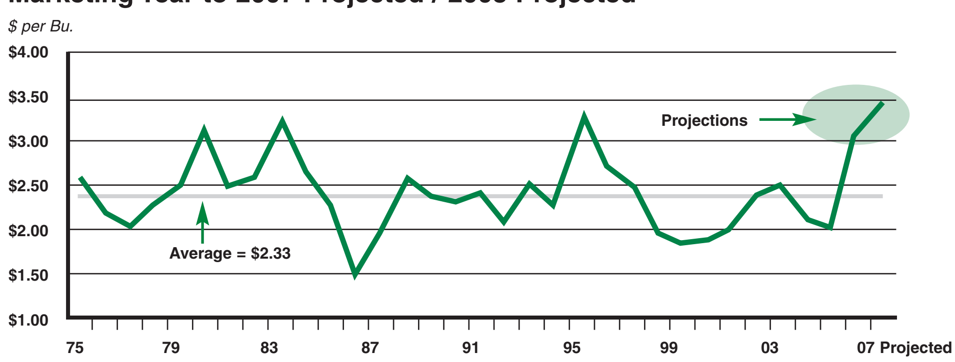
Increased ethanol production is fueling more than increases in commodity prices. It is raising farmland returns. The higher returns have farmland owners eyeing higher rents.

How much a farmland owner shares in the farm's return varies with the lease. Cash rent leases may be preferred by risk-averse owners who ask a pre-determined cash rent. A flexible cash lease or crop share lease may appeal to owners who want to share in the risks and rewards of price uncertainties. Lease payments are based on the realized prices and yields.

Commodity Prices

While corn prices in the United States varied between 1975 and 2006, they averaged $2.33 per bushel *(see figure 1)*. Projected corn prices for both the 2006/2007 and 2007/2008 marketing years are significantly more than the $2.33 historical average. Current projections for the 2006/2007 marketing year are $3.05. The 2007/2008 price for corn is projected even higher at $3.40 per bushel. If prices remain above $3.00 per bushel in both 2006 and 2007, it will be a first. Average corn prices in back-to-back years have never been above $3.00.

Figure 1: U.S. Average Corn Prices, 1975/76 Marketing Year to 2007 Projected / 2008 Projected



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Due to the demand for corn in ethanol, average corn prices are expected to remain high in the next several years. This may be a once in a lifetime increase similar to the commodity price increase during the early 1970s.

What is less clear, however, is what the average corn prices will be. Will prices average $.25 above the $2.33 per bushel average? Or will the average increase be closer to $.50 or a $1.00? That is hard to predict.

Cash Rents

We do know that average cash rents have been increasing. In Illinois, for example, cash rents averaged $122 per acre in 2002, $123 in 2003, $126 in 2004, $129 in 2005, and $132 in 2006. Cash rents averaged a $2.50 increase between 2002 and 2006. Within the Corn Belt, many states have had similar increases *(see below).*

Average Per Acre Cash Rents in Midwestern States, 2003–2007

Year	AK	IL	IA	MN
2003	71	123	122	82
2004	75	126	126	83.5
2005	76	129	131	86.5
2006	76	132	133	88
2007	80	141	140	94

Source: U.S. Department of Agriculture. National Agricultural Statistical Service, *Land Values and Cash Rents 2007 Summary.* **August 2007.**

Larger-than-normal increases in average cash rents are anticipated. A study by the Illinois Society of Professional Farm Managers and Rural Appraisers indicates that the average rent increase in 2008 will likely be double those in recent history.

Many cash rents for 2008 will be negotiated this summer and early fall. At this time, commodity prices will have been above historical levels for more than a year. Many farm managers and landowners are expected to negotiate for higher cash rents with the assumption that commodity price increases will be sustained.

Flexible Cash Leases

The challenge in determining cash rents is that the long-run average commodity price levels are unknown. While it is reasonable to expect higher commodity prices, how much higher is uncertain. This increase, however, will directly impact reasonable cash rent amounts. On farmland that averages 150 bushels of corn, for example, each $.10 per bushel increase in price results in $15 additional revenue, assuming no other changes in production costs.

This price uncertainty has more landowners considering flexible cash rent leases. With these leases, the cash rent varies with price or yield levels. These rental arrangements let landlords bear more of the risk of price declines or yield shortfalls than typical cash rent arrangements. It also rewards them when prices and yields increase.

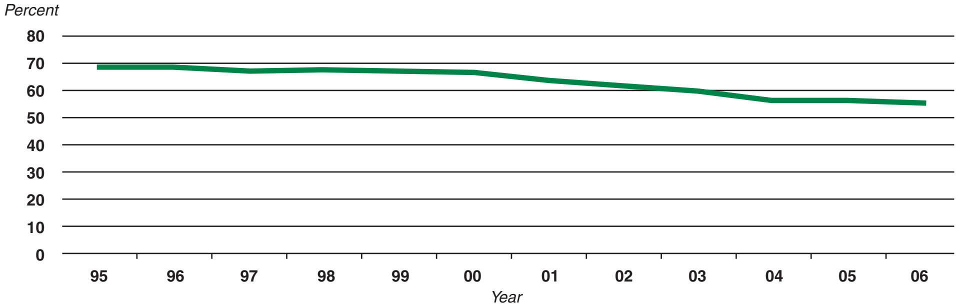
Currently, flexible cash rents make up a small portion of total farmland leases. While interest in them has increased, their share of total leases may not increase because they are somewhat involved. For instance, federal commodity program payments typically are shared unless the rent is based on factors unrelated to production or pricing on the farm being rented. In general, determining the extent of government program sharing presents challenges.

Crop Share Lease

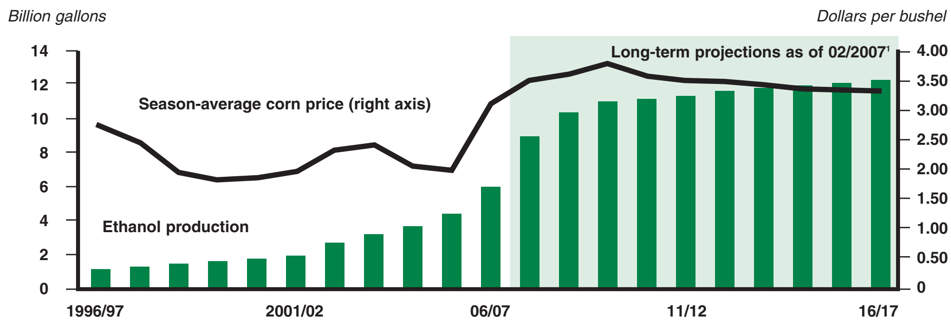
Another alternative to flexible cash leases is the crop share lease. The percent of farmland rented using crop share leases has been declining. In central Illinois, for example, the percent of farmland crop shared by

Figure 2: Percent of Farmland Share Rented by Central Illinois Grain Farmers

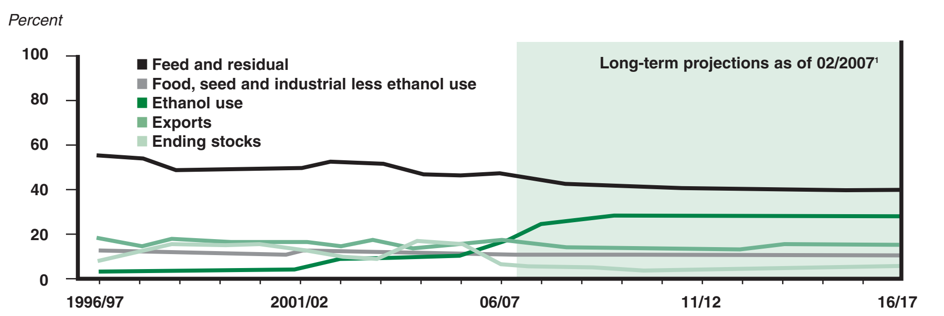
Source: Illinois Farm Business Farm Management



As ethanol production increases, corn prices rise and attract additional corn area…



…and ethanol's share of total corn disappearance rises at the expense of other uses



Source: U.S. Department of Agriculture, Office of the Chief Economist, World Agricultural Outlook Board, USDA Agricultural Projections to 2016, Long-Term Projections Report OCE-2007-1, February 2007.

grain farmers enrolled in Illinois Farm Business Farm Management decreased from 68% in 1995 to 55% in 2006 *(see Figure 2).*

Given recent commodity price increases, many landowners with crop share arrangements in 2006 had higher returns than landowners with cash rent leases. Crop share leases effectively share the risks and rewards of uncertain price and yield levels.

Summary

Commodity price increases are affecting farmland leases. In coming years, cash rents are expected to increase. Use of flexible cash leases and crop share leases may increase too due to uncertainties in corn prices.

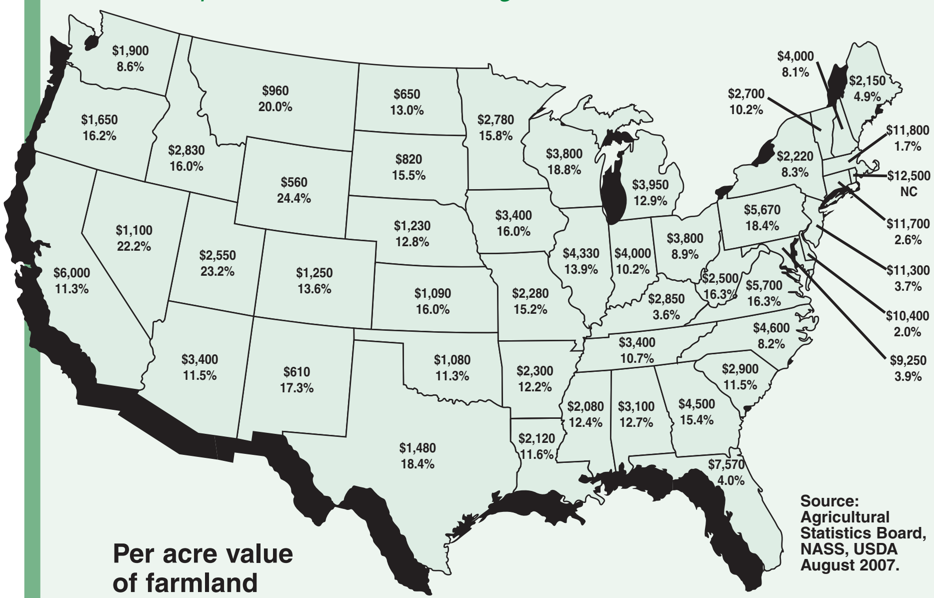
Dr. Gary Schnitkey *serves as a professor and farm management specialist in the Department of Agricultural Economics at the University of Illinois. His extension activities focus on risk management and farm income evaluation.*

Outside the Corn Belt

Outside the Corn Belt, less pressure exists for increased cash rents. While commodity prices for wheat, cotton and rice have moved some, their production costs have increased due largely to increased energy costs. Crops with more energy-intensive production practices have seen larger cost increases. Irrigated production, for example, has seen one of the largest cost increases due to pumping costs.

Consider, for instance, that non-land production costs in Arkansas on loamy soils using center pivot irrigation are estimated at $475 per acre. In central Illinois, production costs for non-irrigated corn are estimated at $300 per acre. The higher production costs and stable crop prices in Arkansas will hold down cash rents while more stable production costs and higher crop prices in central Illinois provide upward pressure. Differences in crop situations make for differences in cash rents.

2007 Farm Real Estate Value by State —
Dollars per Acre & Percent Change from 2006



Per acre value of farmland

USDA average as of January 1, 2007 (top number)
Percent change from January 1, 2006 (bottom number)
U.S. Average – Dollar/Acre: $2,160 • Percent change from 2006: +13.7%

Farmland Values Continue Up

Farm real estate values, a measurement of the value of all land and buildings on farms, averaged $2,160 per acre nationwide on January 1, 2007, up 14% from 2006, according to the National Agricultural Statistics Service (NASS) of the U. S. Department of Agriculture. The $2,160 per acre is a record high and $260 more than a year earlier.

The increase in farm real estate values continues to be driven by a combination of many factors, according to NASS. These include strong commodity prices and farm programs, outside investments, favorable interest rates and tax incentives, and continued commercial and residential development.

A Snapshot *cont. from page 1*

and 2002 Censuses of Agriculture, with sales measured in constant 2002 dollars, according to the ERS.

- For the most part, large-scale farms are more viable businesses than small family farms. The average operating profit margin and rates of return on assets and equity for large and very large family farms were all positive in 2004, and most of these farms had a positive operating profit margin. Small farms were less viable as businesses.
- Small farm households rely on off-farm income. They typically receive substantial off-farm income and do not rely primarily on their farms for their livelihood. Most off-farm income is from wage-and-salary jobs or self-employment.
- Most farms, 61% in 2004, receive no government payments and are not directly affected by farm program payments.
- A growing number of farms operate under production and marketing contracts to guarantee an outlet for their production.

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Mark Goodwin & Associates Real Estate LLC
131 Airport Drive • Unit H
Joliet, IL 60431

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