Farmland
IN PERSPECTIVE

Winter 2007/08 Volume 28, No. 4

GOODWIN

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

Mark Goodwin
Real Estate Broker

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

Ethanol Has Far-Reaching Impact

The explosive growth of U.S. ethanol production is being felt by nearly every aspect of the field crops sector – domestic demand, exports, prices and the allocation of acreage among crops – as well as the livestock sector, farm income, government payments, and food prices, according to the Economic Research Service of the U.S. Department of Agriculture.

- **Domestic use vs. exports:** As the ethanol industry absorbs a larger share of the corn crop, higher prices will affect domestic use and exports, providing for more intense demand competition between domestic industries and foreign buyers of feed grains.
- **Animal feed:** Livestock feeding, the largest use of U.S. corn, typically accounts for 50-60% of total use. According to the USDA 2007 long-term projections, corn for animal feeding is expected to decline to 40-50% of total use during the next decade due to higher prices.
- **Global trade and international markets:** The U.S. typically accounts for 60-70% of world corn exports; however, higher corn prices are projected to reduce this share to 55-60% during much of the next decade, a result of reductions in foreign demand and increases in foreign production.

Continued on page 2

2007 Farm Bill Will Likely Impact Farmland Values and Rents

by Professor Kent Olson
Department of Applied Economics • University of Minnesota

Federal farm policy certainly can impact farmland values and rents. Policy, rules and budgets change, however, and so do their impacts. While change is likely in the coming year, the impact on values and rents remains to be seen.

Current federal farm policy, the Farm Security and Rural Investment Act of 2002, expired at the end of September 2007. For a year, and longer in some views, Congress has debated the next farm bill, and a high number of farmers, landowners, citizens, lobbyists, companies, environmentalists, churches, non-profits, and many others both here and abroad have voiced their opinions and ideas.

Some of the issues and proposals for the new farm bill are so contentious that Congress had not agreed on a new policy by mid-November. In July, the House passed their version of the new bill, but at press time, the Senate had not passed their version. The President, however, has indicated he will veto either version; and if Congress does not override that veto, the resulting impact on land will likely be two fold:

- A greater emphasis on the revenue-based commodity income support system as described below, *and*
- A reduction or even elimination of the priced-based systems.

Historical Perspective

Historically, farm bills have affected farmers and Midwest farmers in particular. During the past few decades, however, farm bills have been expanded to include many other issues. Current policy, for example, includes provisions affecting not only farm commodities, but also conservation, trade, nutrition programs (including food stamps), credit, rural development, research, forestry, and energy.

The nutrition programs account for about 70% of the total estimated expenditures in the 2002 Act. The importance of food, nutrition, and energy programs has caused both the House and Senate to include "food" and "energy" in the titles of their bills as well as "farm."

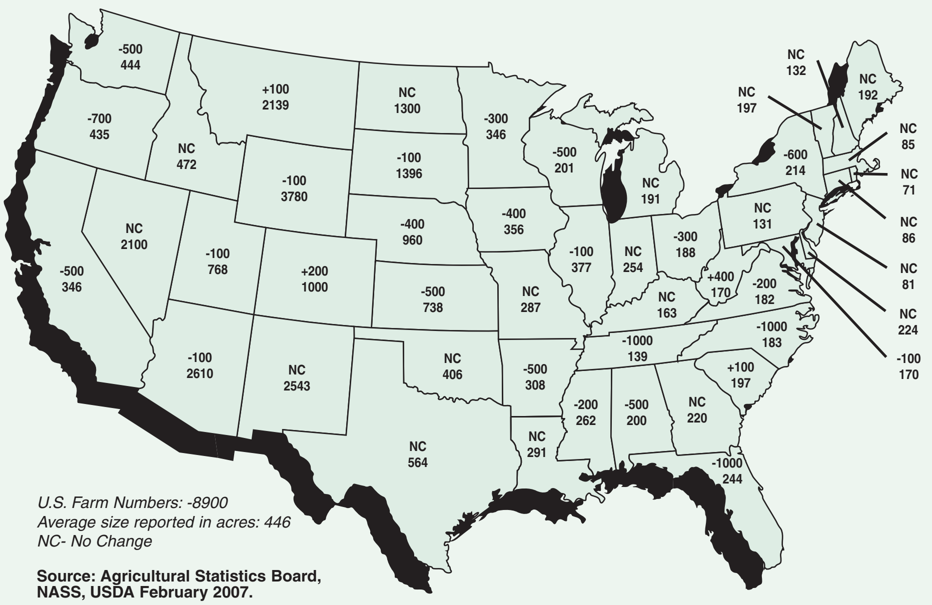
Continued on page 2

Changes Continue in Farm Demographics

The number of farms in the United States in 2006 was estimated at 2.09 million, 0.4% fewer than in 2005, according to the Economic Research Service (ERS) of the U.S. Department of Agriculture (USDA). Total land in farms, at 932.4 million acres, decreased 780,000 acres or 0.08%, from 2005. The average farm size was 446 acres during 2006, an increase of one acre from the previous year. The decline in the number of farms and land in farms reflects a continuing consolidation in farming operations and diversion of agricultural land to nonagricultural uses.

The largest percentage changes from 2005 occurred in the smallest and largest sales classes. Farms with total annual sales of $1,000 to $9,999 declined 1% to 1.15 million farms. Meanwhile farms with total annual sales of $500,000 and more increased 2.4% to 81,350 farms. The number of farms with less than $100,000 in sales fell 0.6% from 2005, and the number of farms with $100,000 or more in sales rose 0.7%.

Change in Farm Numbers Since 2005, by State *(top number)*
Average Farm Size Reported in Acres 2006, by State *(bottom number)*



Source: Agricultural Statistics Board, NASS, USDA February 2007.

2007 Farm Bill *cont. from page 1*

The most direct impact on farmland values and rents comes from the commodity programs, but strong indirect impacts can also be felt from the energy and conservation programs. Smaller impacts could be felt from the rural development, forestry, horticulture, and organic programs.

Commodity Programs

In the commodity programs of both the House and Senate versions, the current payment rules for wheat, corn, soybeans, rice, and other small grains were preserved but with increases in some target prices and loan rates. Both the Senate and House added new, optional safety nets based on revenue.

If the current payment rules are kept in place, pressure on land rents and values will continue. Current rules provide for a direct payment plus a counter-cyclical payment if the crop's selling price is between the crop's target price (minus the direct payment) and loan rate. And if crop prices drop below the crop's loan rate, a farmer can receive support through the marketing loan program – usually through a loan deficiency payment (LDP).

Revenue-Based Payments

Both the House and Senate have included their own versions of a new, optional safety net that is revenue-based rather than the current price-

Ethanol *cont. from page 1*

- **Crop production:** Higher producer returns provide economic incentives to increase corn acreage. As a result, adjustments are expected in crop rotations between corn and soybeans. Other sources of land for potential increased corn plantings include crop-land used as pasture, land in fallow, acreage returning to production from expiring Conservation Reserve Program (CRP) contracts, and shifts from other crops, such as cotton. During 2007, farmers planted nearly 93 million acres to corn, an increase of more than 14 million acres (18.6%) from 2006.
- **Price variability and market volatility:** The increased use of corn to produce ethanol is projected to result in higher corn prices. This will trigger reductions in other uses and increases in supplies to bring the corn market into equilibrium. Nonetheless, stronger ethanol demand will result in lower carryover stocks of corn. At the same time, ethanol demand is very inelastic (unresponsive to price changes) in the range of prices expected during the next decade and relative to other major demands for corn, such as feed use and exports. Thus, overall demand in the corn sector is projected to become more inelastic as ethanol production grows. In combination, these factors will make the corn market more vulnerable to shocks, such as production shortfalls due to weather, pests, or other factors. Low stocks provide limited buffers to shocks. As demand for corn becomes more inelastic, a greater change in market price would be needed in response to a shock to bring the market to equilibrium. Thus, overall price variability and market volatility in the agricultural sector are likely to increase.
- **Net farm income:** Overall, ethanol expansion will boost net farm income. To some extent, these gains are expected to be offset by somewhat higher production expenses for inputs such as seed, fertilizer, and livestock feed.
- **Government payments:** Higher prices for corn and other crops also mean smaller government payments under

based system. For farmers (and thus landowners), a revenue-based safety net provides income protection when the physical yield is severely damaged. Under a price-based safety net, the actual yield is needed to determine the level of a potential government payment for a specific year. If the yield is lost due to drought or other cause, the payment equation will show a payment of zero because the yield is zero – even though market income is also zero.

The revenue-based system will most likely be attractive for farms in areas prone to large yield losses. For those farms, the revenue-based system will provide more income stability which will increase the land's value and the pressure to raise rent.

I should make a cautionary note here. Both the revenue-based and price-based safety nets are designed to cover losses due to large, say national, impacts in the market. Individual farmers still need to consider purchasing crop insurance to improve their coverage of losses due to hail and drought, for example, at the farm and local level.

Conservation

The House, Senate, and the Administration all want to increase funding for conservation, energy, and other programs. Only the size of the increase is in question at press time. Increased funding for conservation programs on working lands can help landowners improve the physical attributes of their land and thus, presumably improve and preserve their value. Increased funding for taking environmentally sensitive lands out of production will provide a fixed income for those owners and will have a small, indirect effect of reducing production and thus increase prices slightly – although this effect will be very hard to see in the marketplace.

Energy Programs

Increased funding for energy programs will increase demand in the short run as new production facilities for alternative fuels are built. In the long run, increased funding for energy research will increase demand for current and new farm products as that research provides improvements in production processes for using corn and soybeans as well as new sources such as, cellulosic material. Compared to the energy provisions in the farm bill, the impact of energy funding may be greater in other bills being debated in Congress that address energy directly.

As a final note, while the new farm policy is very important, higher current and projected crop prices will have a much larger impact on values and rents for the next few years. We see the higher levels already. However, even the excitement generated by higher crop prices is being dampened by large increases in prices for fuel, seed, fertilizer, and other inputs. That is, higher crop prices will likely raise land value and rents, but not as much as we might think because profits are not increasing at the same pace as crop prices.

Kent Olson, Ph.D., *Professor of Applied Economics, University of Minnesota, advises graduate and undergraduate students and teaches farm management, world food problems, and agribusiness management on campus and internationally. He is the Area Program Leader in Agribusiness Management for the University of Minnesota Extension.*

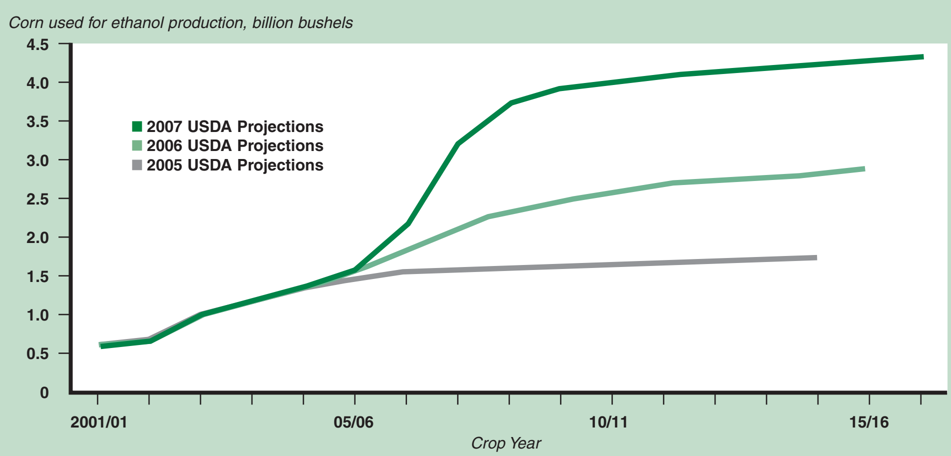
Dr. Olson also has commitments to applied research. His research emphasizes farm-level management issues such as the interaction between farming and the environment, sustainable agriculture, decision-making, and the impact of government policies. Besides whole-farm analysis, his research has concentrated on individual crops: corn, soybean, wheat, rice, cotton, alfalfa, and rangeland.

Dr. Olson has worked in Sweden, Uganda, Poland, and Italy on the decision-making processes of farmers, grazing management, the farm-level impacts of alternative crop production techniques related to sustainable agriculture, and the transition of state farms.

current farm commodity programs, particularly price-sensitive marketing loan benefits and counter-cyclical payments. In contrast, with higher crop prices the use of land for production becomes more valuable, so new rental rates for land enrolled in the CRP are likely to rise.

- **Food prices:** Retail price increases for red meats, poultry, and eggs are projected to exceed the general inflation rate in 2008–2010, as the livestock sector adjusts to higher feed costs. As a result, overall retail food prices would rise faster than the general inflation rate in those years.

High oil prices and Energy Policy Act of 2005 raise corn-based ethanol production



Sources: ***USDA Agricultural Projections to 2016,*** **February 2007;** ***USDA Agricultural Baseline Projections to 2015,*** **February 2006;** ***USDA Agricultural Baseline Projections to 2014,*** **February 2005.**

Farmland
IN PERSPECTIVE

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

ADDRESS SERVICE REQUESTED

Prsrt. Std.
U.S. Postage
PAID
Chicago, IL
Permit No. 1705

PRINTED WITH SOY INK