

Farmland

IN PERSPECTIVE

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GOODWIN

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Ethanol Reduces Government Support

The surge in the use for corn in ethanol production is increasing the price of corn received by producers. It also is reducing the income support received by the nation's feed grain sector, according to the Economic Research Service of the U.S. Department of Agriculture.

During the past decade, a large share of farm support has come from income support programs such as marketing loan benefits, market loss assistance or counter-cyclical payments, and production flexibility or direct payments. Now, however, market revenue, stimulated in part from renewable energy policies and strong energy prices, is increasing in importance to the sector, according to a recent ERS report.

Ethanol demand for corn is raising feed grain prices above farm program support levels, thereby reducing or eliminating marketing loan benefits and counter-cyclical payments.

Continued on page 2

World Grain Situation – What's Driving Current Crop Prices?

Dr. Darrel Good, University of Illinois

Wheat, corn, and soybean prices were quite volatile during the summer of 2006, as is often the case during the northern hemisphere growing season. However, those prices turned decisively higher in September 2006 and remained relatively high into the spring of 2007.

Several factors contributed to the recent period of sustained high prices. Two are discussed here. First, for wheat and coarse grains, declining world production in 2005 and 2006 contributed to an environment of much smaller inventories.

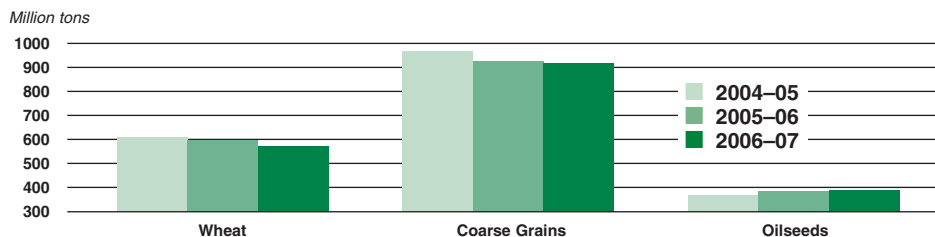
Smaller Inventories

World wheat production in 2006-07 was 4 percent smaller than in 2005-06 and nearly 6 percent smaller than the 2004-05 crop. Production in the most recent year was down substantially in the U.S. (14 percent), the republics of the former Soviet Union (6 percent), the European Union (5 percent), and Australia (58 percent).

Similarly, coarse grain production was reduced in the U.S. (6 percent), Canada (10 percent), Argentina (23 percent), the European Union (4 percent), and Australia (51 percent). The reduction in U.S. production reflected the failure of the markets to compensate corn producers for the accelerating costs of production in 2006.

In contrast, lower production has not been a price supporting factor for soybeans. Both the U.S. and South America harvested record large soybean crops in the 2006 calendar year, resulting in record large world oilseed production [Fig. 1]. However, soybean prices have been supported by the rapidly growing demand for soybean meal in China to support increased livestock production as rising incomes there have increased the demand for meat. That trend is expected to continue, although interruptions can be expected with occasional slowing of economic growth.

Figure 1: World wheat, coarse grain & oilseed production



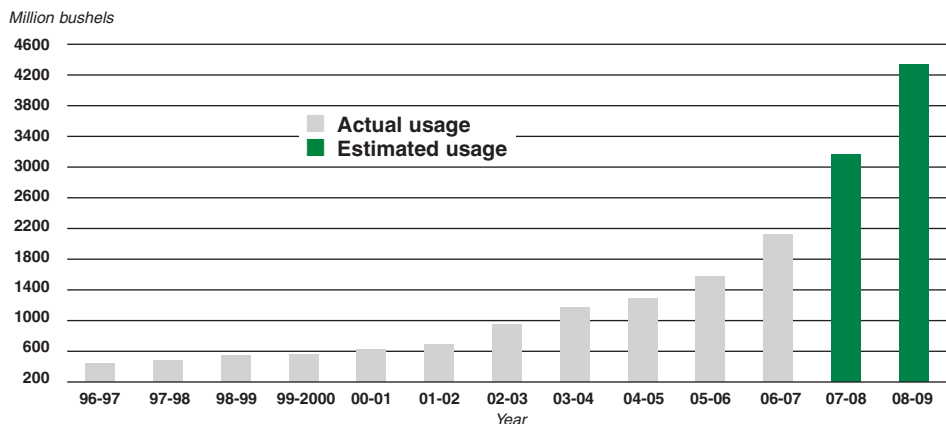
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Production Uncertainty

As the 2007 northern hemisphere growing season got underway, uncertainty about the extent of the potential rebound in world grain production and the magnitude of world oilseed production still remained:

- South America (Brazil and Argentina) were in the process of harvesting very large corn and soybean crops.
- In May 2007, the USDA forecast that the 2007 corn crops in Brazil and Argentina would be 19 percent and 39 percent larger, respectively, than the crops of 2006.
- The Brazilian and Argentine soybean harvests were expected to be 3 percent and 12 percent larger, respectively, than the previous record crops of 2006.
- U.S. winter wheat producers seeded 9 percent more acreage for harvest in 2007 than in 2006. Even with some freeze damage, crop conditions through early spring of 2007 were generally very good. In May, the USDA forecast a 20 percent increase in production.
- High wheat prices will also likely stimulate increased production in Canada, the Ukraine, Kazakhstan, the European Union, and Australia. It appears that world shortages of wheat will give way to a more abundant supply situation in 2007 and 2008. The most uncertainty centers on western Australia, where drought conditions persisted in early 2007.

Figure 2: Corn used for ethanol production in the U.S.



U.S. producers planned to increase corn acreage by 15 percent and reduce soybean acreage by 11 percent in 2007. Increased corn acreage will likely come from reductions in acreage devoted to cotton, spring wheat, and other oilseeds in addition to soybeans. With a favorable growing season, then, U.S. corn supplies will be much larger in 2007-08 and soybean supplies will be smaller, but large enough to maintain a surplus.

Ethanol's Impact

A second significant factor contributing to high crop prices since the fall of 2006 has been the rapid expansion of corn used for ethanol production in the U.S. The USDA estimates that 1.323 billion bushels of U.S. corn were used for ethanol in 2004-05 and 1.603 billion in 2005-06.

The May 2007 forecast for the 2006-07 marketing year was 2.15 billion bushels and was 3.4 billion bushels for the 2007-08 marketing

year. As of May 8, 2007, the Renewable Fuels Association estimated that 118 plants in the U.S. were currently producing ethanol and that those plants had capacity to produce 6.087 billion gallons of ethanol.

In addition, eight of those plants were adding capacity and 79 new plants were under construction. The annual capacity of those additions was estimated at 6.43 billion gallons. That new capacity should more than double the amount of U.S. corn used for ethanol production over the two-year period of 2007-08 and 2008-09 (Fig. 2).

The recent rapid increase in U.S. ethanol production has been stimulated by significant subsidies, the spike in crude oil prices in the summer of 2006, and congressionally mandated production levels. Biofuels production is mandated at 4.7 billion gallons for 2007, increasing to 7.5 billion gallons by 2012. Clearly, existing and planned capacity exceeds mandated production levels.

Ethanol cont. from page 1

In the 2005 marketing year, income support for feed grains totaled \$10.5 billion, coming from marketing loan benefits, counter-cyclical payments, and direct payments. In marketing year 2006 and the next several years, stronger prices are expected to reduce income support to include only direct payments.

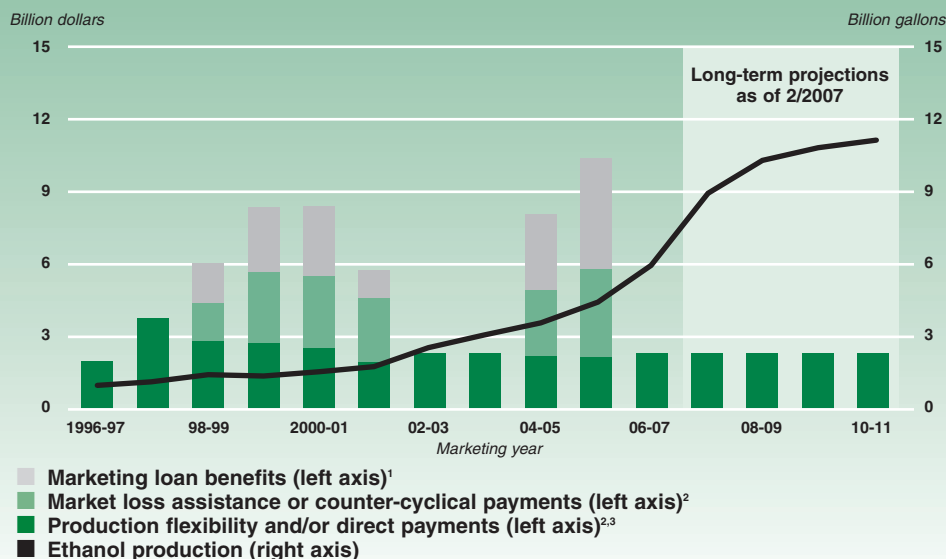
¹ Payments are made to feed grain producers.

² Payments are made to owners of feed grain production flexibility contract acres or owners of feed grain base acres. These payments are based on historical, not current production, so recipients of these payments may not necessarily be producing feed grains.

³ Direct payments are assumed to continue in 2008/09 through 2010/11, although this will be determined by forthcoming farm legislation.

Sources: USDA, National Agricultural Statistics Service; USDA, Farm Service Agency; and USDA Agricultural Projections to 2016, OCE-2007-1, February 2007.

Ethanol reduces government support for U.S. feed grain sector



The potential for further expansion in ethanol production beyond current planned capacity will depend heavily on the price of crude oil and the price of ethanol relative to unleaded gasoline. Ethanol prices have been and currently are at a significant premium to unleaded gasoline prices. That premium may be difficult to maintain if congressional production mandates are not increased. The current political climate, however, favors increased mandates and the continuation of large subsidies for biofuel production.

Future Outlook

Even with a rebound in U.S. and world wheat and coarse grains production in 2007-08, crop prices are likely to remain at relatively high levels due to political support for biofuels production. A prolonged period of high prices has wide-ranging implications, including higher farm incomes, higher farmland values, higher food prices, and changes in farm policy.

Darrel Good

is a Professor in the Department of Agricultural and Consumer Economics, University of Illinois. He has Extension and research responsibilities in the areas of agricultural price analysis and grain marketing. Dr. Good is the author of the Weekly Outlook and Grain Price Outlook newsletters and has helped develop the comprehensive farm risk management website www.farmdoc.uiuc.edu.



Verbal Lease Notification Dates

If you would like to write new lease terms with your tenant, you would be well advised to honor the following verbal lease notification dates.

State	Traditional Verbal Lease Year*	Traditional Verbal Notification Date*
ARKANSAS	Jan. 1 – Dec. 31 But may vary. Consult your farm manager.	June 30
ILLINOIS	Mar. 1 – Feb. 28	Oct. 31
INDIANA	Mar. 1 – Feb. 28	Nov. 30
IOWA	Mar. 1 – Feb. 28	Prior to Sept. 1 Recommended that notices be provided in writing and sent by certified mail.
MINNESOTA	Not well defined. Consult your farm manager.	Not well defined. Consult your farm manager.
MISSOURI	Mar. 1 – Feb. 28 (Sometimes Jan. 1 – Dec. 31)	60 days prior to the day the oral agreement was given on.
WISCONSIN	Mar. 1 – Feb. 28	Dec. 1 90 days advance notice is required to terminate a verbal lease.

* Traditional lease year and notification date for verbal leases. In some states, the lease continues "as is" unless notified by a specified notification date. Lease years and notification dates may vary based on the terms of a written lease. Consult your farm manager or attorney for confirmation.

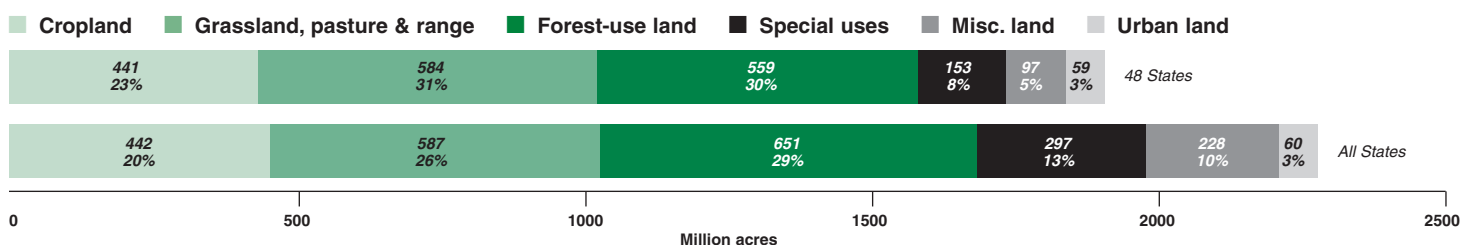
U.S. Land Uses — The U.S. contains approximately 2.3 billion acres of land: 97% (2.2 billion acres) is rural and 3% (60 million acres) is urban. Major uses of land, according to the most recent agricultural census, 2002, were:

- 26% Grassland pasture & range, 587 million acres
- 20% Cropland, 442 million acres
- 19% Forest-use land, 651 million acres
- 13% Special uses, 297 million acres
- 10% Misc. other land, 228 million acres
- 3% Urban land, 60 million acres.

Notes: The area of each major land use is listed in millions of acres with the corresponding share of the total land base in parentheses. Urban uses are listed as a separate category and are not included under the special uses category as was done in previous *Major Land Uses* reports. The land base includes streams and canals less than one-eighth mile wide, and ponds, lakes, and reservoirs covering less than 40 acres. Distributions by major use may not add to totals due to rounding.

Sources: Estimates are based on reports and records of the Bureau of the Census (HUD/BOC, 1992, 2002, 2003) and Federal, State, and local land management and conservation agencies including DOI/BLM, 2003; DOT/BTS, 2004; DOT/FAA, 2002; DOT/FHWA, 2002; DOT/FRA, 2004; USDA/FS 1989, 1998; DOI/FWS, 2001; GSA, 2001; GDT, 2000; USDA/NASS, 2004a, 2005; DOI/NPS, 2002; USDA/NRCS, 2000, 2004a; and WI, 2002.

Major uses of land in the United States, 2002



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