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

The Changing Face of Agriculture in Mexico

While the historical roots of corn are firmly planted in Mexico where corn was first domesticated, it no longer reigns as the dominant Mexican crop. Mexico is not self-sufficient in corn production, according to the U.S. Department of Agriculture.

- Mexico produces twice as much sugar as corn. Sugar cane is Mexico's largest crop.
- Fruit, vegetable and flower production are more profitable than corn production. Mexico provides nearly 90% of U.S. tomatoes and is the principal provider of watermelons, strawberries, onions, chili, lemons, and papayas.
- Mexico ranks as the world's largest producer of avocados and is the largest supplier to the United States where it has 66% of the market.
- Mexico has become a net corn importer. While white corn is grown in Mexico, yellow corn is imported to feed poultry and livestock. Mexico has become the fourth largest producer of chickens and eggs worldwide, and the sixth largest pork producer.

Booming Land Values Create Opportunities & Uncertainties

by Mike Duffy • Economics Professor • Iowa State University

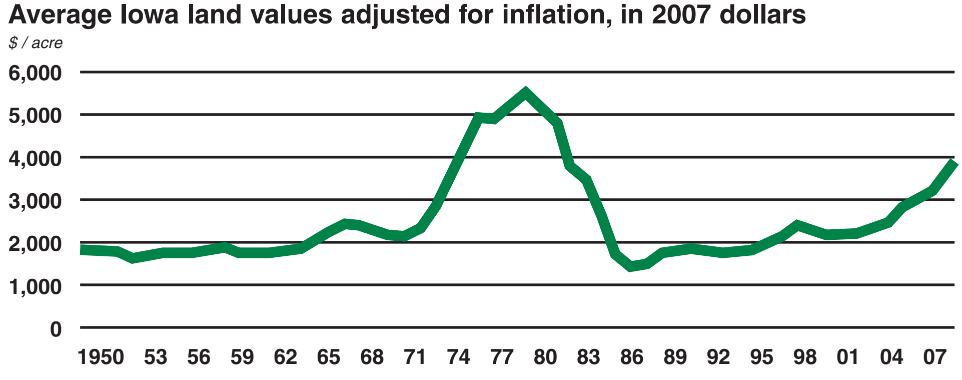
While today's surge in farmland values is reminiscent of the early 1970s, it also differs from the 1970s. The 1970s were characterized by inflation, increasing interest rates, highly leveraged land, and land values that had been stable since the 1960s. In 2008, inflation concerns exist, but interest rates are at near record lows, buyers who can come from many sectors are not highly leveraged, and land values are relatively high. In Iowa, for example, land values set records the last five years.

In the 1970s, land values rose in response to commodity price increases that were driven by export demand. Today's land values are rising in response to commodity price increases that are driven by increased total demand, both domestic and export.

In Iowa, land values increased 22% in 2007. They have more than doubled since 2000. Farmland values in the Seventh Federal Reserve District Board (Illinois, Indiana, Iowa, Michigan and Wisconsin) have reported similar increases. For the District as a whole, land values increased 16% in 2007.

What is driving the market? How long will the value of farmland continue to increase at this pace? Is farmland a good investment today? These somewhat perennial questions remain as relevant as ever.

Average Iowa land values adjusted for inflation, in 2007 dollars



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Land Price Drivers

The predominant factor affecting today's Corn Belt land market is ethanol production. The increased demand for ethanol stems to the energy bills of 2005 and 2007 which set renewable fuel standards. The 2007 bill set a renewable fuel standard of 36 billion gallons by the year 2022. Today's primary renewable fuel is corn-based ethanol.

The sudden increase in demand for corn caused skyrocketing commodity prices. The U.S. average price of corn in 2005 was $2.00 per bushel. In 2007, it doubled to $4.00 per bushel. Soybean prices rose from $5.66 per bushel to $10.40 during the same time period. In Iowa, the gross revenue per acre of corn increased from $336 per acre in 2005 to $592 in 2007. The gross revenue for soybeans climbed from $286 to $405 during the same time period.

These are truly remarkable increases. Similar income increases in a non-short crop year have not been seen in decades. Farm income is the primary determinant of land values. As long as income remains high, values will remain strong or increase.

The value of land used for other crops has seen varying levels of upward pressure too. The value of wheat land has increased more than the value of rice and cotton land. As the price of these commodities increase so will their land values. Idled land that can be brought back into production also has seen value increases.

Another factor affecting land values is the strong demand for recreational land or land for second homes. This demand is localized in areas with desirable amenities, but definitely is putting substantial upward pressure on land values. With the weaker economy, demand appears to have softened in some areas. Yet prices for prime recreational properties seem to be remaining strong. In Arkansas, for example, hunting land has brought two to three times the price of row crop land.

Non-agricultural factors affect land values too. In Arkansas, natural gas royalty and leasing has raised pasture values to levels higher than those of irrigated row crops. When Wal-Mart began requiring all suppliers to have sales staff on site in Bentonville, Ark., land values doubled.

Ownership Trends

Farmers have historically been the primary purchasers of farmland. In the early 2000s, however, investors became much more active in the land market. The stock market and other investments became less attractive and a surge in 1031 tax-deferred exchanges occurred. With the ethanol boom, this pattern changed. After 2005, farmers became much more active in the market as their incomes increased.

A long-term force driving the land market is aging farmland owners and what they will do with the land. In 1999, more than one-fourth of the farmland in the U.S. was owned by individuals age 70 or older. In Iowa, in 2002, almost one-half the farmland was owned by individuals age 65 or older. More than three-fourths of the farmland owners indicated they will transfer their land to their families, either through inheritance, trusts, gifts or sales. Almost half said that equal division of the land among the family was the best approach to estate planning.

This change from one generation to the next will diffuse farmland ownership. It carries many implications including increases in absentee ownership, in the use of cash rents, and in the amount of rented land.

What the second generation will do with the land remains to be seen. Seventeen percent of the non-operator landowners in a recent survey indicated they are holding the land for sentimental or family reasons. Whether or not sentimentality is stronger than today's high prices remains to be seen.

Downward Pressures

Skyrocketing production costs are putting a major damper on land value increases. Fertilizer and seed prices have more than doubled. Diesel prices increased more than a third in the past year and are continuing to increase. Rents will likely average 25% higher in 2008 than 2007.

Other, more short-term, factors also merit watching. For instance, what will be used to make ethanol? Today, most ethanol is produced using corn. Discussions for the next generation of ethanol focus on using crops high in cellulose such as corn stalks and switchgrass. Other materials are being considered too. Because the same land base will be used, income from the land should remain high. If the future generation of ethanol is made from algae, kelp, garbage or some other material, though, land incomes could come under pressure.

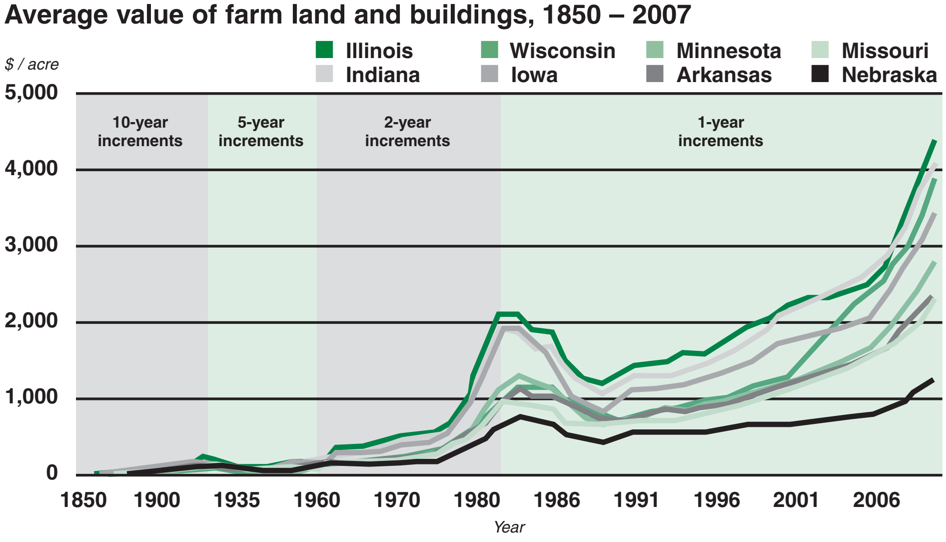
Other Factors

The supply and demand for ethanol is a consideration too. Currently we have a mandate for use, tax credits for blenders, and a tariff on imported ethanol. Whether or not these will hold into the future remains to be seen. We will have to move from use of ethanol as an additive to use as a fuel replacement.

A major determinant of the profitability of ethanol is the price of oil. This is such an unstable situation that it could change at any time, either up or down. But, over the long-term the price of oil will increase. Barring political instability, availability will not be a problem anytime soon. What will be gone is cheap oil.

What happens in the general economy or macro-situation will

Average value of farm land and buildings, 1850 – 2007



impact farmland owners. The de-valuing of the dollar makes our exports relatively cheaper, and so demand has remained strong. But, a weaker dollar also makes our imports (fertilizer and oil) more expensive.

The current fears of a recession also impact land values. Land has always been viewed as a safe place to put money in an uncertain time. It remains to be seen if this pattern will hold in times of record land values.

The subprime mortgage crisis could have spillover effects on the farmland market, especially through credit availability. At this time, it does not appear that an undue amount of debt is being incurred with farmland purchases. Credit availability for qualified borrowers does not appear to be much of a problem. People who are interested in real estate will be looking toward farmland in the current market. Many of the properties, especially in the housing market, just simply do not appear that attractive.

Other uncertainties exist, as they always have. It seems, however, that the number of uncertainties increases as the price of farmland increases.

Barring any unforeseen major change in the current situation, farmland prices appear to be strong and with upside potential. Deflating the Iowa land value survey numbers shows that in today's dollars the actual peak occurred in 1979 at $5,550 an acre. This is more than $1,000 per acre above today's average prices. One Iowa study estimates that if price relationships hold as they were in 2005, Iowa average land values could reach $8,000 an acre.

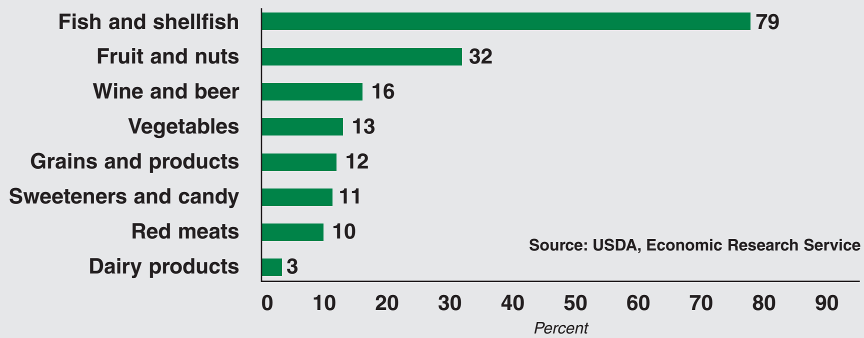
The ethanol boom has changed the dynamics of the farmland market. The changing situation has increased uncertainties and raised questions about sustainability. Regardless of your point of view, this is an exciting time and opportunities exist in land ownership.

__Michael D. Duffy__, a professor in the Department of Economics at Iowa State University, works as an Extension Economist in Farm Management, is the Director of the Iowa State Beginning Farmer Center, and had served as the Associate Director for the Leopold Center for Sustainable Agriculture. Dr. Duffy is a member of the American Agricultural Economics Association and the Soil and Water Conservation Society.

The U.S. Taste for Imports

Through the 2000s, the foods Americans ate increasingly were imported. That is because bananas, coffee, chocolate, fish and shellfish, apple juice, cashew nuts, spices and other imported foods are produced in greater quantity or less expensively abroad. Is some cases, they cannot be produced in the United States.

Import shares by volume are highest for fish and shellfish, 2000–05



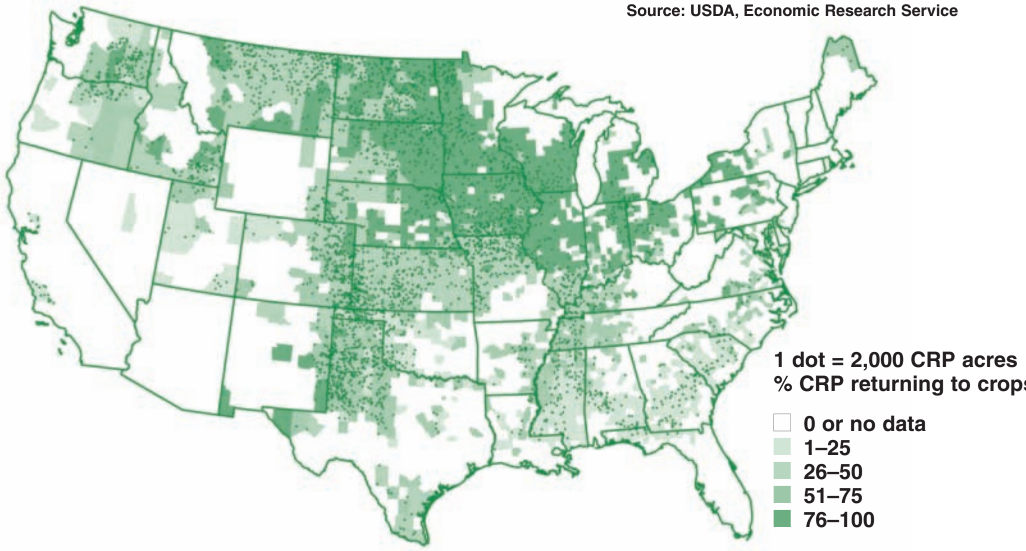
Land Use After a CRP Contract

The first of the 10- and 15-year contracts with the Conservation Reserve Program (CRP) expired between 1995 and 1997. Use of land previously in the CRP in the contiguous 48 States was examined by the Economic Research Service (ERS) of the U.S. Department of Agriculture. The ERS found that approximately 38% of the land that exited CRP between 1995 and 1997 was not converted back to crop production in 1997. These CRP lands tended to remain in pasture, range, or forests – uses with land covers and environmental benefits similar to those contracted under CRP.

The CRP offers annual rental payments to farm owners or operators who voluntarily stop crop production on eligible land and instead plant environmentally beneficial grass or tree covers. The CRP pays about $1.8 billion per year to retire almost 37 million acres. Benefits from the program, including increased recreation, enhanced wildlife habitat, soil conservation, and other environmental services, have been valued in excess of program costs.

The likelihood that CRP acres would return to production varies widely

Source: USDA, Economic Research Service



Note: Each dot represents 2,000 acres enrolled in CRP as of 1997, but dot size is not proportional to actual land area. The color shading indicates the estimated share of CRP land in a county that would have returned to crop production had contracts expired by 1997.

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

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