

# More farmland for sale in softer market

## 2007 Outlook



By **BRUCE HUBER**

ILLINOIS' land market was relatively flat in 2006 as the influx of 1031 exchange buyers declined. The increase in interest rates in 2006 slowed

housing starts, which reduced the need for new housing developments. With fewer housing starts, developers are asking for an extension on the options they have to purchase the development land or the developer simply allows their option to expire and walks away from the potential purchase.

This came as no surprise to anyone involved in farmland real estate. Nothing goes straight up. There are usually corrections along the way, and farmland may be prime for a short-term correction. There were signs of weakening in the farmland market during the summer months. A few auctions were "no sales," meaning the seller failed to achieve a minimum desired selling price and would not sell. Some investors focused

## Correction

In our November issue, on page 16, we ran a story about annuities. In that article we noted that index annuity gains are taxed as capital gains. In fact, all gains above the principal invested in an annuity are taxed as ordinary income. We regret the error.

## Key Points

- Land on the market is moving slower than a year ago.
- A 10% drop in land prices could entice farmers to re-enter the market.
- Values of large prime farmland tracts and recreational land are holding strong.

on the failed auctions or on the sale prices of farms that sold at the lower end of the market. This may have prevented some investors from being aggressive buyers.

The number of advertised farms for sale this year could lead one to believe the market is extremely oversaturated with available farm properties. When one looks deeper into the availability of prime farmland, especially tracts of prime farmland over 320 acres, there is not an oversupply. The large prime tracts have held their value as they are still in great demand.

## Overpricing problem?

Is it taking longer to market farm properties? Yes. It only stands to reason that fewer buyers would result in longer marketing periods, but prices have remained strong. I believe there may be a slight softening of prices in Illinois in 2007. This decrease may not be noticeable in prime tracts, but slightly sub-par land or poorer-quality farms will most likely have measurable decreases.

Some sellers hear about the high sale prices and automatically think their farm is worth more than its actual value. Overpricing may be a real problem in

the upcoming year as local land buyers (including farm operators) will need to re-enter the land market to replace the exiting 1031 exchange buyers. These buyers tend to be more conservative as they are not working with dollars obtained from extremely inflated development land.

The non-1031 exchange buyer does not have the same motivation and typically will not push values higher. However, this does not mean that land values cannot be maintained.

## Buyer shift

Farm incomes have been good over the past three to four years, and commodity prices were rising into this year's harvest. With biofuels as a part of the national energy plan, commodities may be entering a new era of consistently higher prices. The farmland market has seen some farmers buying at the current price levels, and they will play a more dominant role in 2007.

A decrease in price would bring opportunity for buyers who have put off purchases the past few years. Interest rates are still very reasonable and commodity prices appear to be headed higher for the next few years.

Non-1031 exchange buyers can easily compete in this market if they refrain from trying to buy the best, especially the large tracts. They can pursue tracts that may not appeal to the outside investor (i.e., rock road frontage, waterways throughout the farm, irregular field shapes, lower productivity soils or farms with some highly erodible land). The latter appears to be an ultimate

turnoff for investment buyers.

However, a property with 50% of the acreage in woods and that has a water source (i.e., creek, pond or river) is in great demand. Tracts of land that fit this description have risen in value substantially over the past few years and show no signs of weakening. Recreational buyers are here to stay and the buyer pool is very large. High-quality recreational tracts already rival the price of tillable farmland in southern Illinois, and I do not see this trend changing much in the future.

In summary, the makeup of buyers will most likely change in 2007 as we move away from the 1031 exchange buyers. Rising commodity prices should provide positive motivation for farmers contemplating a farmland purchase. The result should be more farmers and local investors entering the market to take the place of the exchange buyers.

Prices may have to soften slightly for this to occur. It is anyone's guess whether this means a 5% or a 15% decrease in values. I am inclined to believe a 10% decrease would generate a great deal of renewed interest in farmland.

One local farmland investor stated he would leverage himself to the maximum to acquire farmland if prices dropped 20%. There are a lot of positive things going on in agriculture and this investor knows that. Agriculture has a great future and this year may provide a great opportunity to invest in that future.

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# Study looks at increase in farm machinery cost

A University of Illinois Extension study can help you estimate your 2006 machinery costs and serve as a guide in determining what to charge for custom farming operations.

University of Illinois Extension Economists Gary Schnitkey and Dale Lattz authored the report "Machinery Cost Estimates for 2006," which showed costs are up significantly from when machinery costs were estimated in 2005.

Three factors contributed to the increase, including a 67% uptick in fuel prices, higher costs for new equipment and a half-percent increase in interest rates.

The diesel fuel price was estimated at \$2.50 per gallon for 2006, compared to \$1.50 per gallon in 2005. Higher fuel prices caused a 60-cent-per-acre increase in total machinery costs for planting and added 40 cents to costs per acre for corn combining.

Says Lattz, "New, larger equipment is more fuel efficient and requires less fuel per acre than smaller, older equipment. Thus, increases or decreases in the cost of diesel fuel have less effect on machinery costs per acre than they did several years ago. But, it is still a significant factor when calculating machinery costs."

## Key Points

- A diesel cost increase drove farming costs up in 2006.
- Combining contributes the most to machinery cost.
- Use 2006 costs as a guide for figuring custom farming rates.

A second factor driving up the estimated costs was higher-priced new equipment. "For example, the list price of the planter used to estimate 2006 costs was 9% higher than the 2005 price; the tandem disk price was up 15%; and the combine price was up 11%," says Lattz.

"Machinery costs are calculated assuming that new equipment is purchased and held for 10 years — seven years for combines. Higher equipment prices contribute to higher depreciation and interest costs," he adds.

Finally, the interest rate used in calculating costs rose from 7% in 2005 to 7.5% in 2006. "A higher interest rate increases the cost of equipment ownership," adds Lattz. "While the interest rate was not increased substantially, it resulted in a minor increase in costs."

Combining is the single machinery

## Field-operation costs balloon 11% to 44%

COSTS of field operations rose significantly this year, compared to last year, according to Gary Schnitkey and Dale Lattz, University of Illinois Extension economists. Here's a look at specific field operations, estimated cost increases and per-acre costs in 2006 vs. 2005.

- Field cultivating rose 44%, from \$6.20 to \$8.90 per acre
- Chisel plowing rose 25%, from \$10.70 to \$13.40 per acre
- Tandem disking rose 20%, from \$8.20 to \$9.80 per acre
- Planting costs rose 14%, from \$8.30 to \$9.50 per acre
- Corn combining rose 11%, from \$31.10 to \$34.50 per acre (six-row head)
- Soybean combining rose 11%, from \$26.30 to \$29.20 per acre (20-foot platform)

operation that contributes the most to machinery costs per acre, according to Lattz. "Combining costs can vary significantly based on the number of acres per year the combine is used on," he says.

■ The complete report is online at [www.farmdoc.uiuc.edu/manage/newsletters/newsletter.html](http://www.farmdoc.uiuc.edu/manage/newsletters/newsletter.html).

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