

Grain Rally Fertilizes Farm Prices

(Wall Street Journal)

By GARY WULF

The surge in grain prices has caused U.S. Midwestern land values to rise as well, but prices have now expanded so far, so fast that some experts worry that the farmland market has become a bubble waiting to burst.

"Recent increases in farmland prices raise questions about whether the farmland price increases are outpacing increases in farmland returns," said Gary Schnitkey, farm financial-management specialist at the University of Illinois extension program.

Farmland values have been one of the few shining spots in the U.S. real-estate market, which has been roiled by a drop in home values, huge losses for firms involved in the subprime-mortgage market and a resultant credit crunch.

With corn, soybean and wheat prices soaring to record levels earlier this year, farmland prices also have been pushed to unprecedented heights. The U.S. Department of Agriculture estimated that the price of an average acre of U.S. cropland rose 13% in 2007, to \$2,700, more than double the \$1,340 price of 1998. It predicts another 15% rise this year.

An annual survey done by the University of Nebraska said farmland in the western cornbelt state rose 23% during the past year, and was worth an average of \$1,425 per acre as of Feb. 1. That increase continues a five-year uptrend that puts average agricultural land values in the state 88% higher than they were in 2003.

"The underlying causes of this new plateau are fairly obvious. Corn demand from the rapidly growing ethanol industry in the state fueled prosperous returns across the corn-producing areas of the state," said Bruce Johnson, the University of Nebraska agricultural economist who conducted the survey. "And, true to economic logic, those income signals get capitalized into agricultural land values relatively quickly."

The previous peak in Nebraska farmland values occurred in 1981, just before a deep drop in prices and a major agricultural crisis.

In Iowa, the value of agricultural land has increased 11% just since September, to push the price of high-quality cropland above \$5,600 an acre in some areas of the state. That six-month surge is the second-largest on record. Land values in Iowa are 67% higher than they were just five years ago.

But a recent slump in both cash and Chicago Board of Trade futures prices for wheat and soybean, largely caused by expectations for a sharp increase in plantings, has some officials concerned.

Mr. Schnitkey at the University of Illinois said farmland prices in his state are now 46% higher than capitalized values, which is the earning potential of that land from agriculture.

"Either a new relationship between farmland prices and capitalized values exists, where farmland prices exceed capitalized values by a large margin -- possibly caused by more urban demand for farmland -- or growth in farmland prices must slow, so that capitalized values catch up with farmland prices," he said.

Any decline in cash prices for wheat or soybeans -- or other crops -- would hurt the land's profit potential, driving down capitalized values even further.

Iowa's superintendent of banking, Thomas Gronstal, warned the U.S. Senate's Banking, Housing and Urban Affairs Committee earlier this year that reverse mortgages and agricultural lending may have a significant impact upon the future of the banking industry.

"We could be witnessing the development of a bubble in agricultural real estate," he said.

The USDA forecasts that farm business debt will stand at about \$228 billion by the end of 2008, up \$8 billion from 2007, to set a record for a fourth consecutive year. Farm-mortgage debt alone is expected to rise 2.8%, to \$120.8 billion, part of a 30% increase over five years.