Land Facts

THE LORANDA GROUP, INC.

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Listening to the Marketplace

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I have the opportunity to speak with people every day about the farmland market. Some days, the conversation focuses on the process and mechanics of buying or selling a specific tract of land. These discussions are relatively straightforward. The client tells me what his or her goals are, and then I advise them of the best way to achieve them, based upon what I've seen work successfully in the past. Other days the questions, and corresponding answers, can be more subjective. For example, clients often ask if I can tell them what land values are going to do in the future.

Is the latter question answerable? If I was to be totally honest, I would probably say no. Why? First, you have to understand all the variables that can potentially impact land prices – variables such as grain prices, interest rates, returns on alternative investments, and tax laws. Then you have to calculate how much each variable will ultimately influence the overall market equation. Finally, you have to hope that nothing changes in the interim that will make your forecasts appear ridiculous or uninformed.

All that said, I am still paid to make predictions and I am willing to do so. But I think I'm going to start simplifying my approach. Because despite all the in-depth analysis that many land market economists undertake, there's another method of predicting price trends that is not complicated – simply determine if there are more people interested in buying land (like we have now) or selling it (like we saw in the mid 1980's). Yes, everything you need to know about farmland price trends you learned in your first economics course! If the demand for land exceeds supply then prices will trend up. If supply exceeds demand then prices will trend down.

When I stop and listen to what the players in the market are saying, my forecasts become much more accurate as I concentrate less on analyzing all of the variables and more on the simple relationship between supply and demand. Here are a couple of examples:

In the fall of 2008, we conducted several auctions in early October. Earlier that summer, all the land market indicators were still positive and we had no reason to believe that the market might be softer. After the first sale was more difficult than we expected because farmers were just not bidding, we wondered if this particular auction was simply an anomaly. However, after the second and third sales were more difficult than expected, we knew that we were seeing a trend and we were one of the first marketing firms to publicly raise the caution flag. Why? We saw that farmer demand was weakening, which would lead to softer land prices.

During the fall and winter of 2009, we talked to many potential land buyers and got a sense that demand might be slowly rebounding. Perhaps most importantly, we talked to numerous potential sellers who were content to hold on to their farm for another year, thus reducing the available supply of land. That led us to believe that prices would likely stabilize into 2010 as there would not be enough farms on the market to meet the increased demand. True to form, prices firmed up and the market is much stronger than it was 12 months prior.

So what can we expect in the next 12 months? Based upon conversations I've had with land buyers and sellers during the past several weeks, I believe that land prices will continue to move higher this fall and winter. Farmers and investors both seem much more eager to bid on land, and the supply of available tracts in most areas will likely remain tight. Of course, there will be exceptions because the overall land market is still comprised of a number of micro-markets. Some of these micro-markets will not see the best crop yields this year due to excessive rain. Others may be saturated with too much available land or land that is not efficient to farm. In general, however, I am optimistic that there will be enough buyers to absorb the land that becomes available for sale.

Finally, I am the first to admit that all the market variables that I noted earlier will influence the decisions that land buyers and sellers will make. That said, I'll let the players filter the information and make the decision, and I'll listen closely to what they're saying. After all, they are the ones writing the checks and signing the deeds, and their opinions and actions are what ultimately count the most.

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The Loranda Group is a diversified agricultural real estate firm headquartered in Bloomington, IL. We offer auction, brokerage, sale/leaseback, and consulting services to agricultural, transitional, and recreational land owners.

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Farmland Lease Trends

One of the most interesting changes I've seen since I've been involved with Midwestern farmland involves the farm lease. Thirty years ago, the vast majority of the farm rental arrangements were based upon the sharing of the crop income and crop expenses. Fifteen years ago, the cash rent lease became more prevalent, as farmers were willing to assume more risk in their operations and wanted more returns from their management. This type of agreement appealed to many absentee investors as they no longer had to write checks for crop expenses or worry about marketing their grain, and they knew exactly how much they were to receive each year.

The volatility we've seen in the grain markets the past 4 years is creating the need for another type of lease – the flex lease. This lease type is not new. There have been variations of it around for several years. Essentially the flex lease tries to incorporate the aspect of the cash lease that landlords found appealing (no expense checks to write and guaranteed payment amount) with the revenue sharing aspect of the crop share lease (when grain prices go up, rent can go up). All this is accomplished by setting a floor rent that the farmer is willing to pay for the land, and then incorporating a formula that calculates a bonus based upon crop prices, actual yields, or both. Sometimes the formula is simple, and sometimes it's quite complex. Most times, it's quite fair.

Keep in Mind: As we've stated in this letter many times, if either the Landlord or the Tenant wants a change in lease terms for the future, then the current year lease must be properly terminated. Each state has its own specific requirements for terminating a lease. The date that the notice must be sent is fast approaching, so be sure to contact your attorney or a knowledgeable real estate professional for details.