

Land Slide or Land Rise?

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My Beliefs: What Drives the Value of Land?

- General idea of purchasing capital assets
 - Obtain the rights to future earnings for a price less than the real earnings that it will produce
- Capital asset values are determined by *EXPECTATIONS* of the level of future earnings and their present value
 - Earnings are difficult to forecast
 - Interest rates and inflation drive present values and are equally difficult to forecast
- It is very difficult to understand when expectations are misinformed
 - Compounded by the fact that farmland is an infinite life asset with relatively low rates of turnover

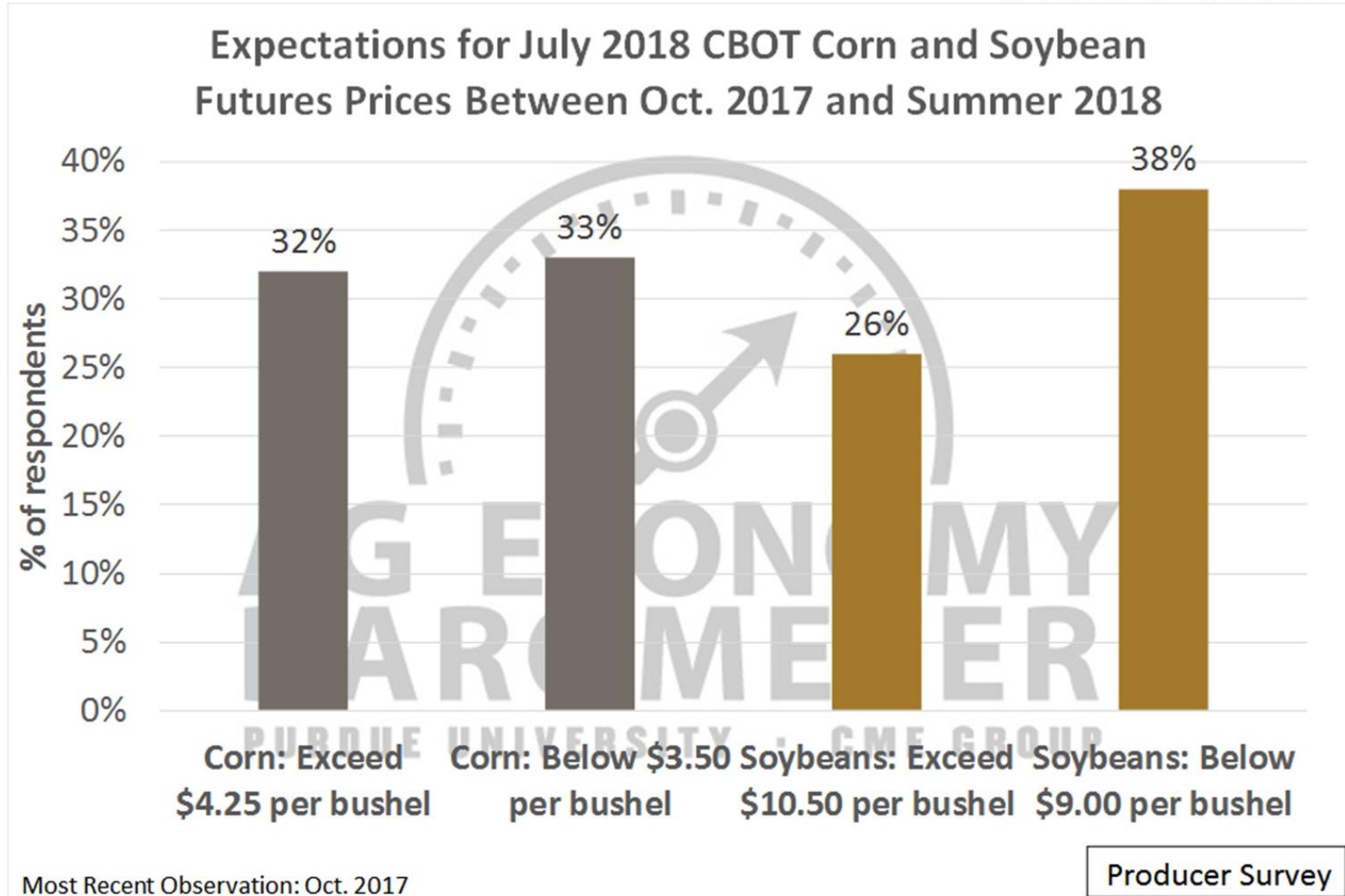
The Key Points

1. Farm Economics – returns and finances continue to trend lower
2. Farmland rents have stayed relatively strong
3. Land prices are being supported by relatively strong rents and very low interest rates
4. When 3 changes land prices will change



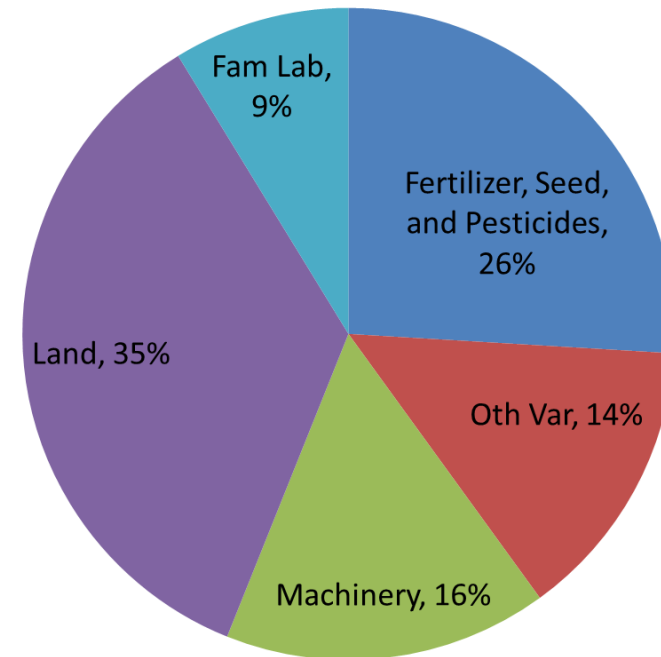
Farm Profitability

Farmers appear to have widely varying expectations for crop prices



What Costs Will Adjust to Alleviate Margin Pressure?

**Percent of Total Expenses, HQ IN Farmland, Average
1991-2015**

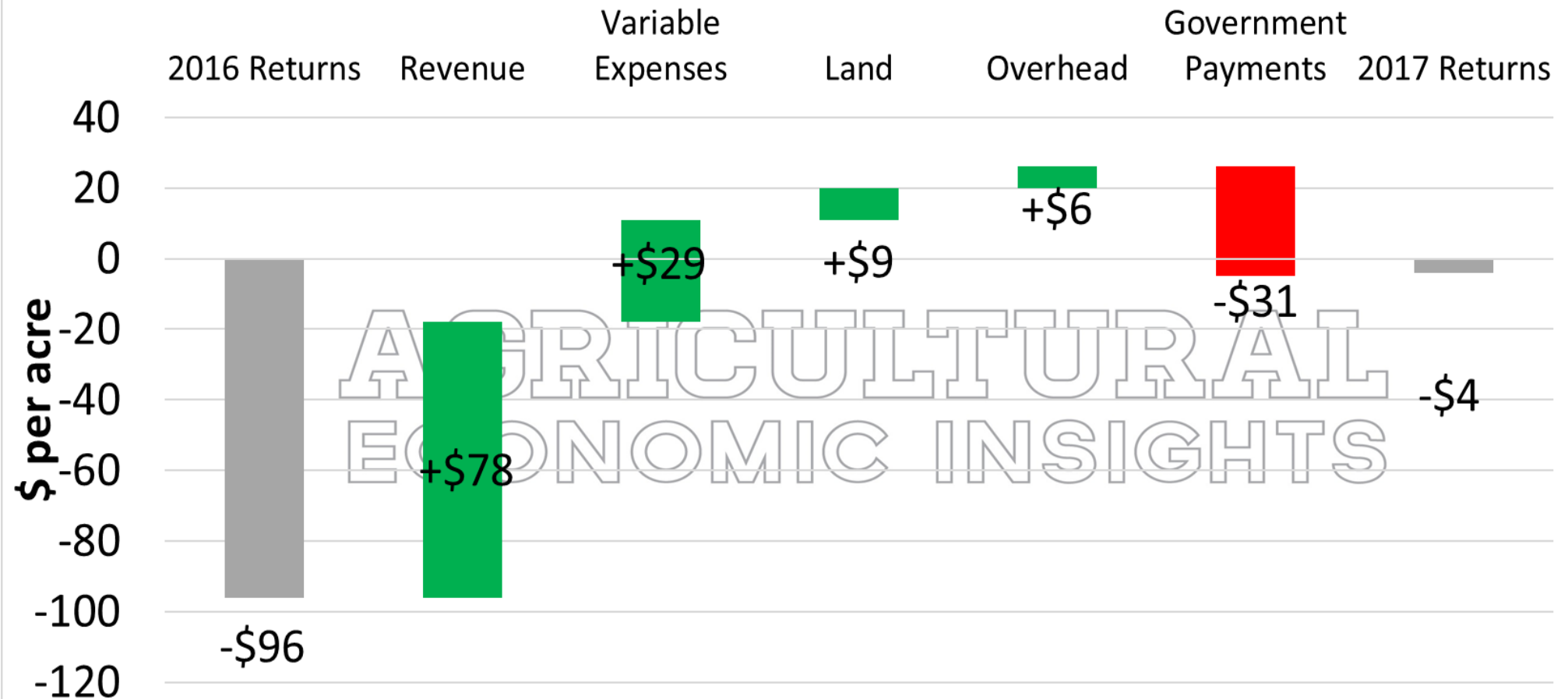


Source: Derived from Purdue Crop Budgets, ID-166, Corn-Soybean Rotation



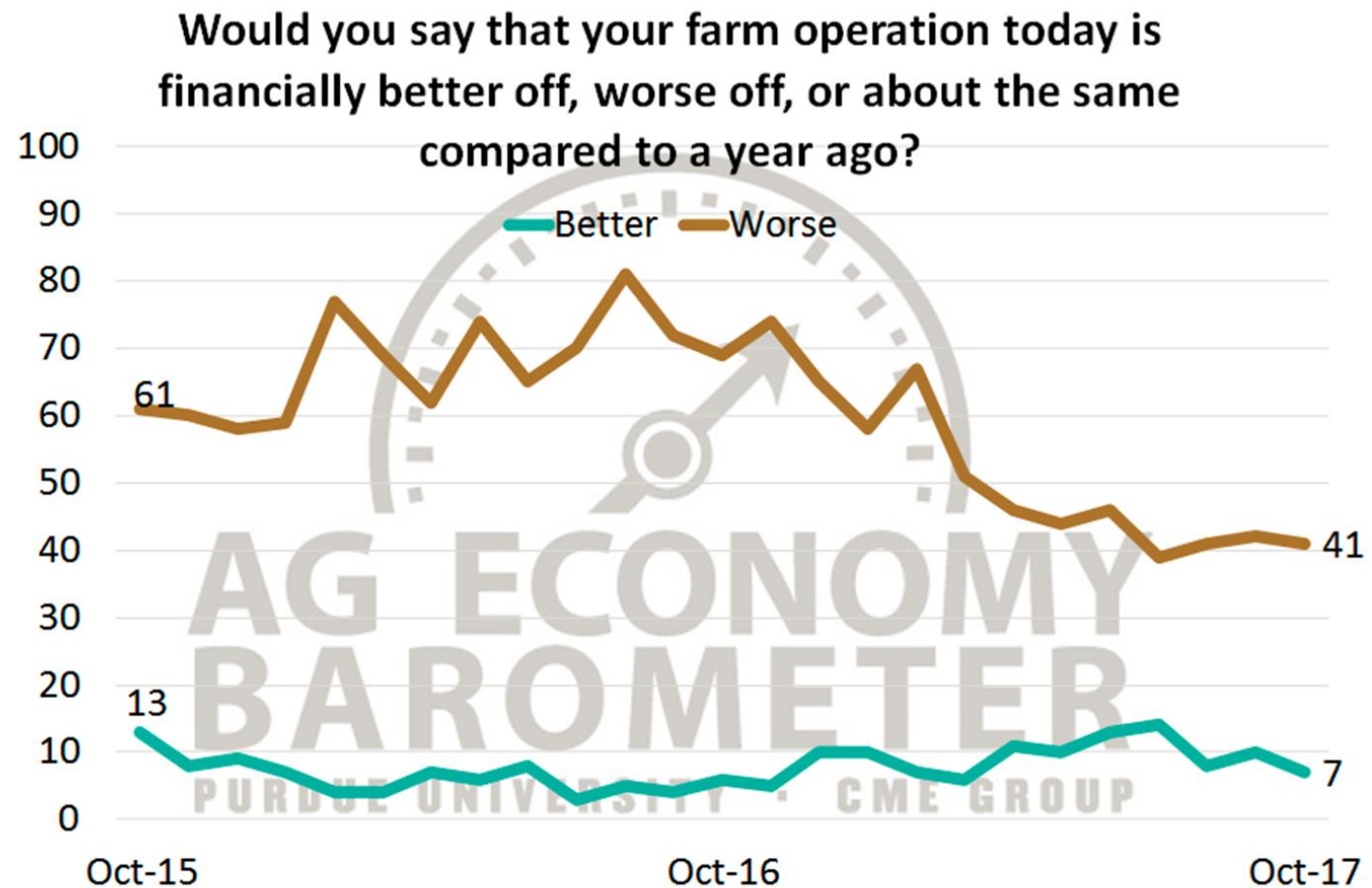
Change in Corn Returns. Heartland Region. 2016 - 2017

Where did the improvement come from?



Do Farmers Have the Financial Capacity to Continue to Subsidize Rent and Land Returns?

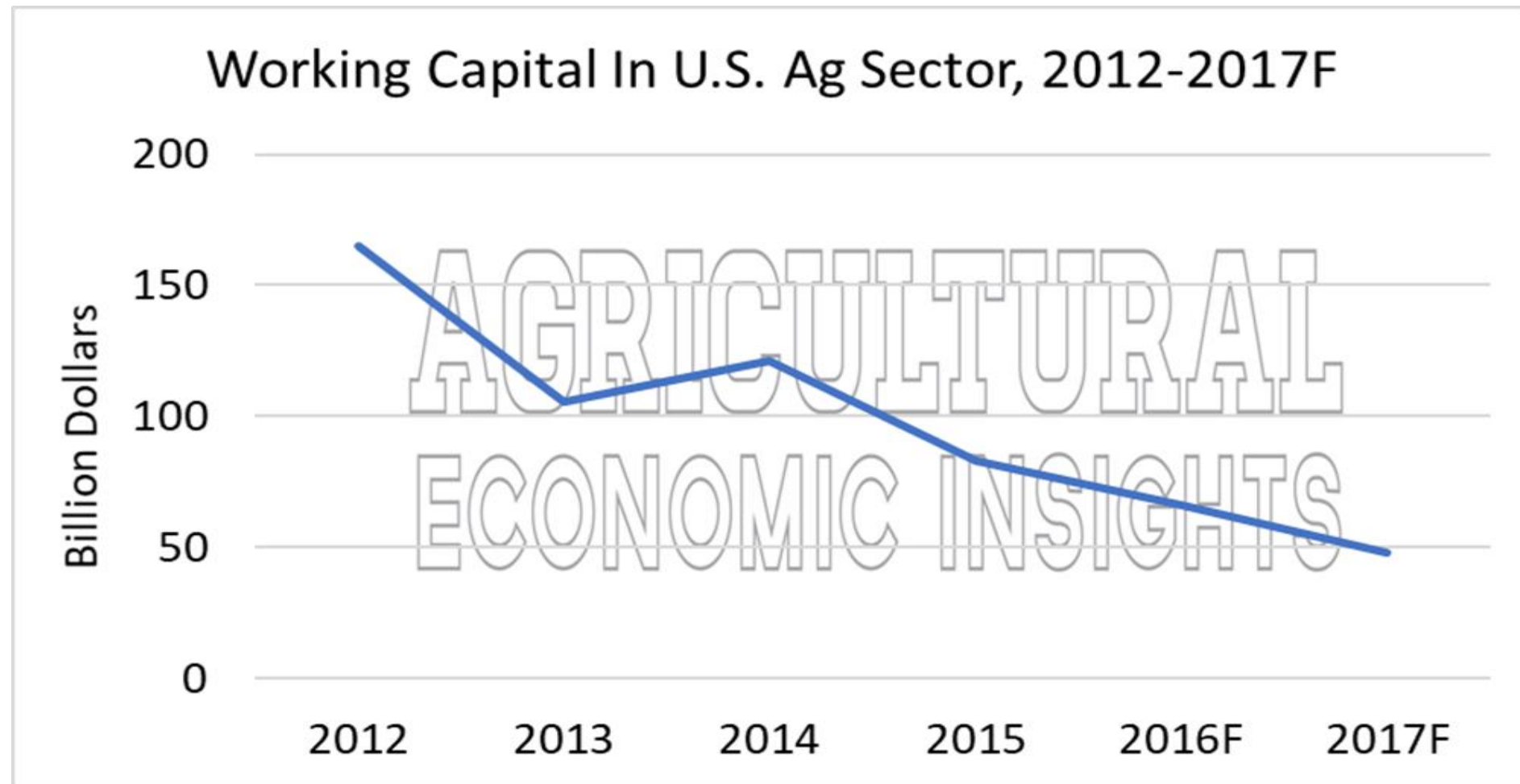
Farm finances are
beginning to stabilize?



Most Recent Observation: Oct. 2017

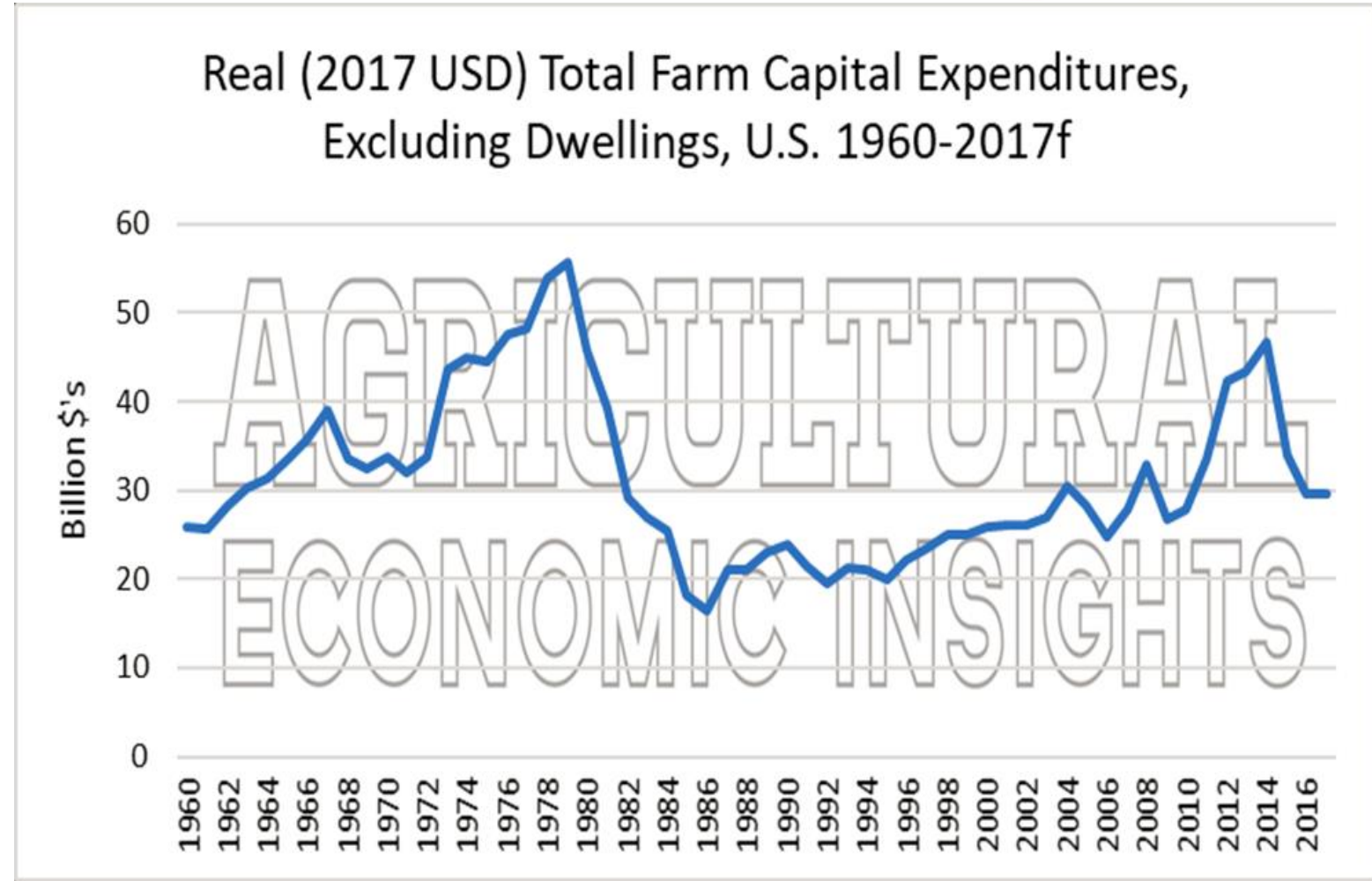
Producer Survey

Working Capital Has Evaporated



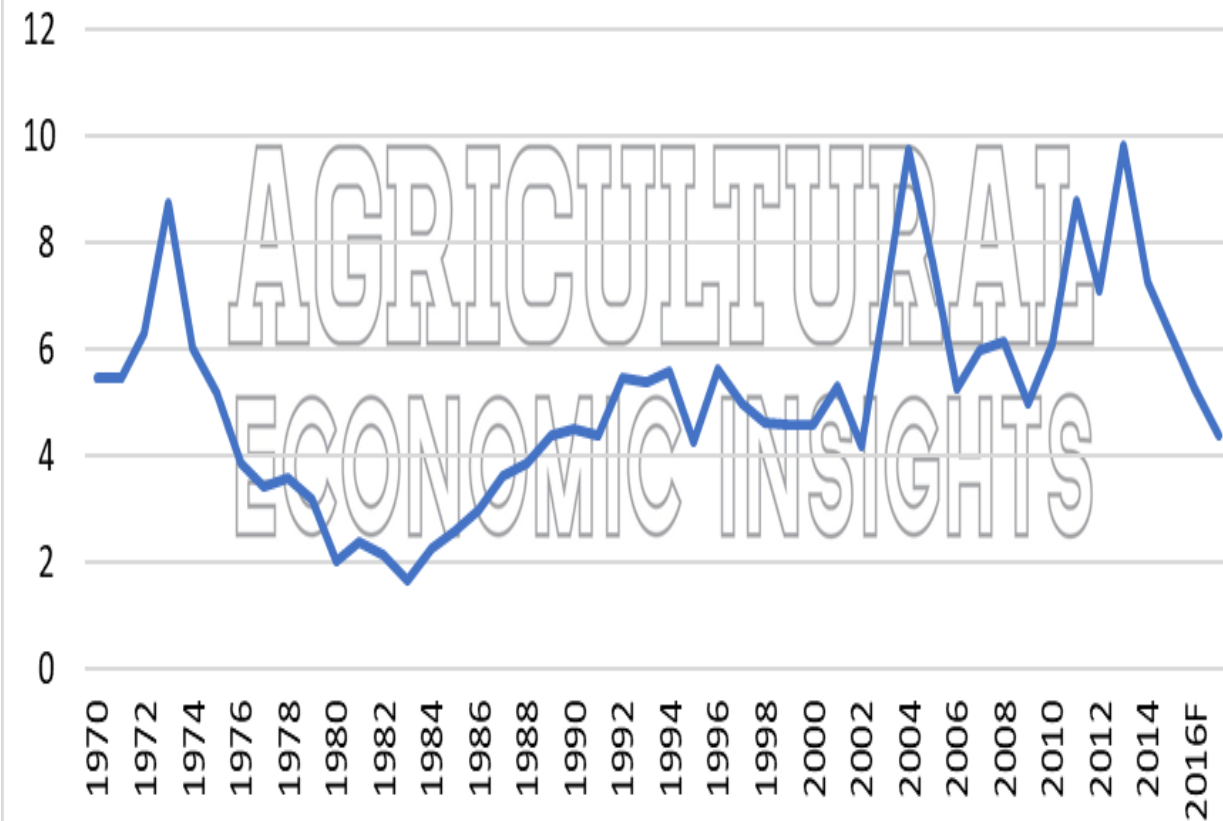
Capital Expenditures Stabilize

If Cap Ex stabilizes
where will the money
come from?

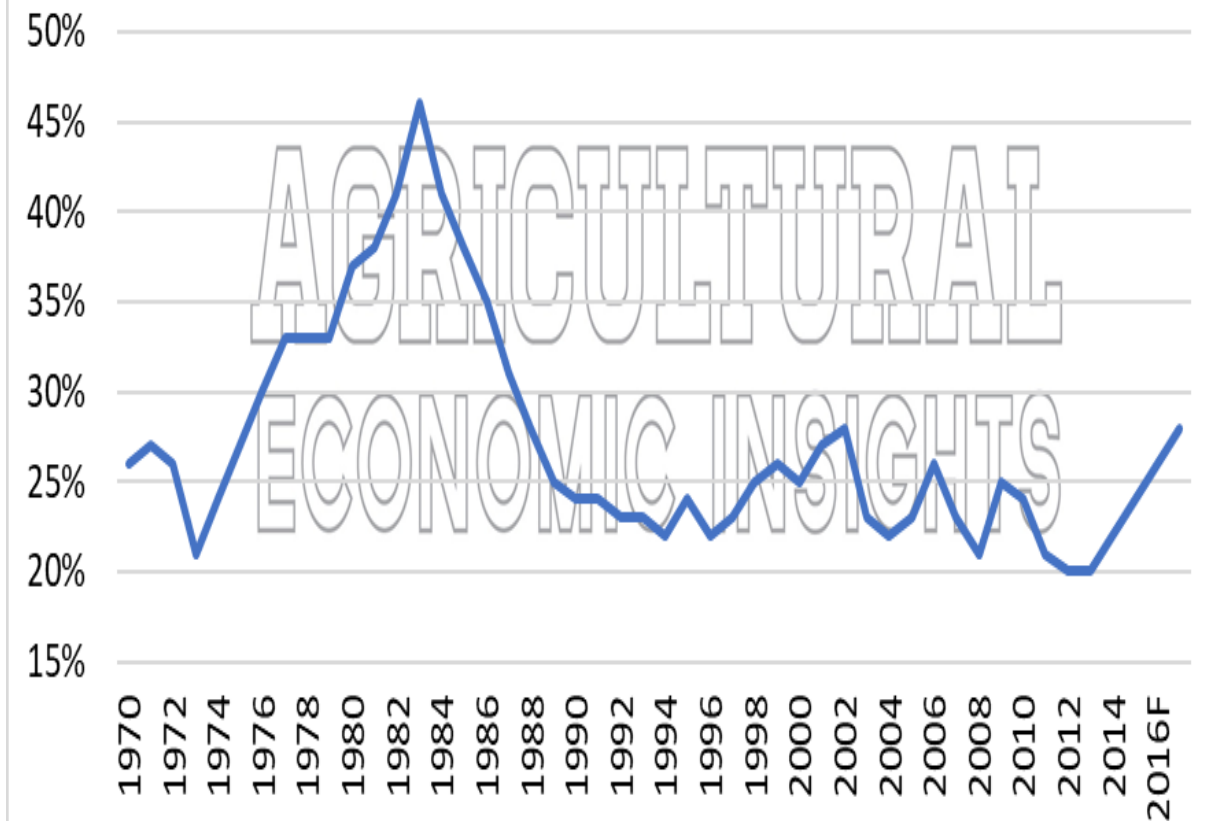


Repayment Capacity Declines Sharply

Times Interest Earned Ratio U.S. Ag Sector, 1970-2017F



Debt Service Ratio, U.S. Agriculture, 1970-2017F

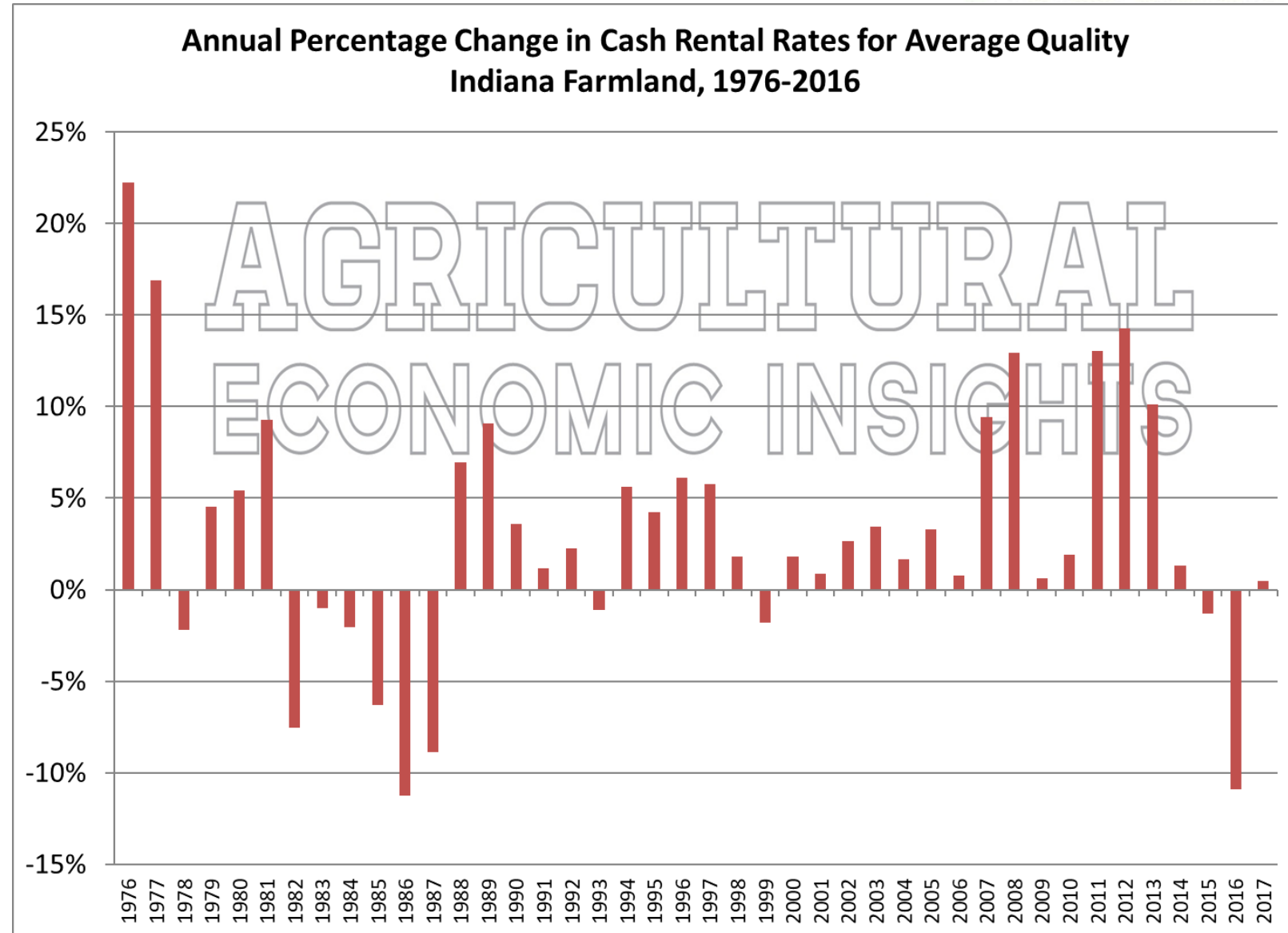


Rents

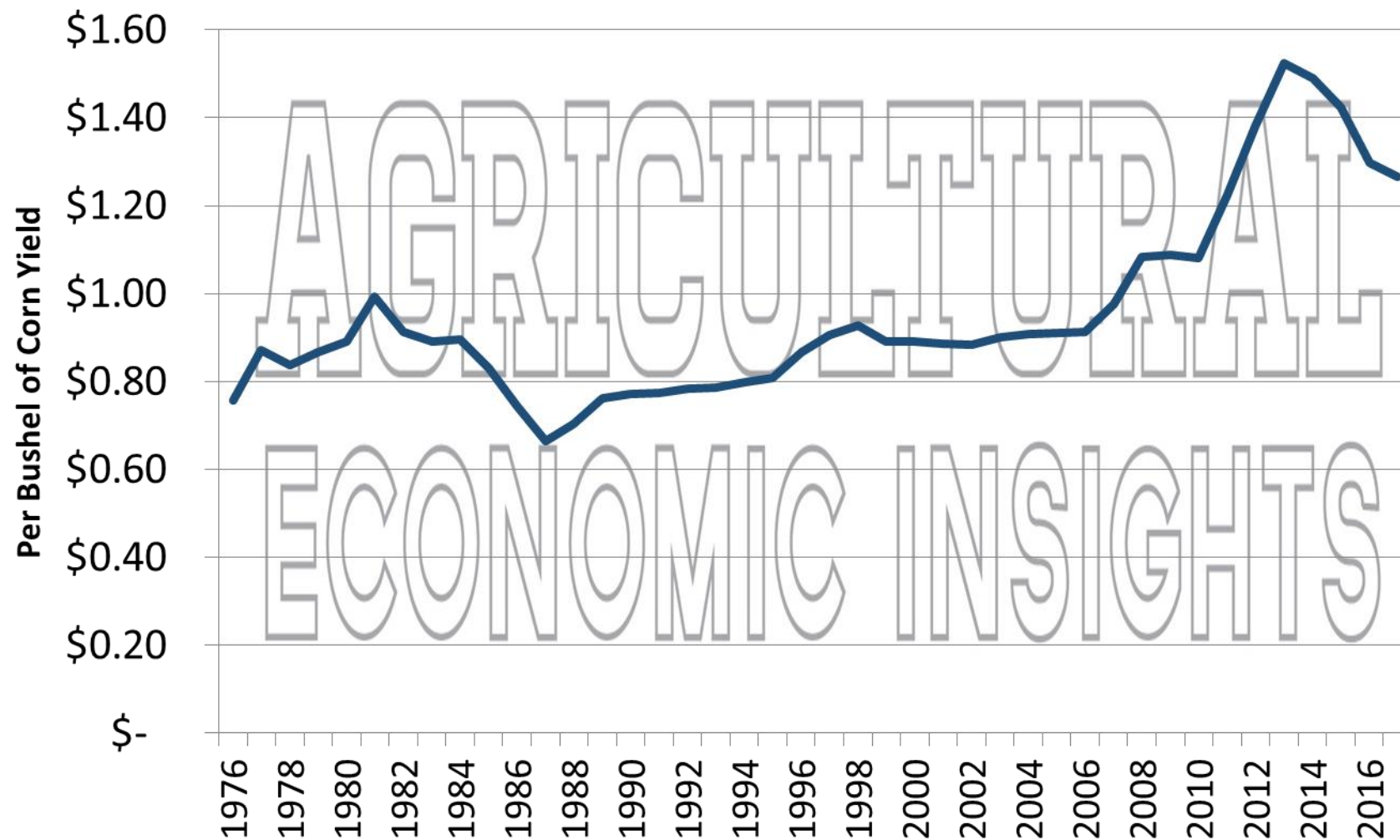
“Corn is not high because a rent is paid, but a rent is paid because corn is high”

-- David Ricardo

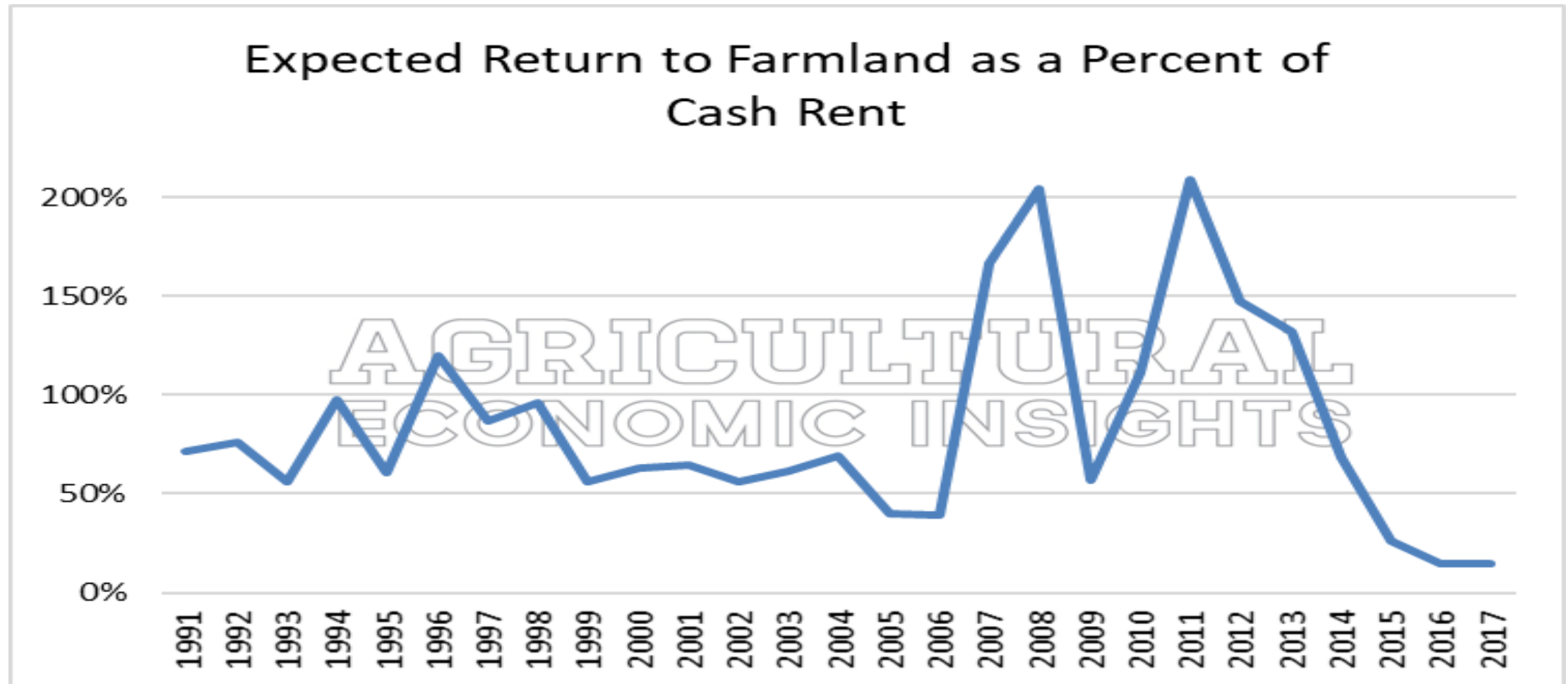
Rents Have Been Falling



Cash Rent per Bushel of Corn Yield, High Quality IN Farmland, 1976-2017



But Has Rent Fallen Enough? Income Cannot Support Rents at these Levels

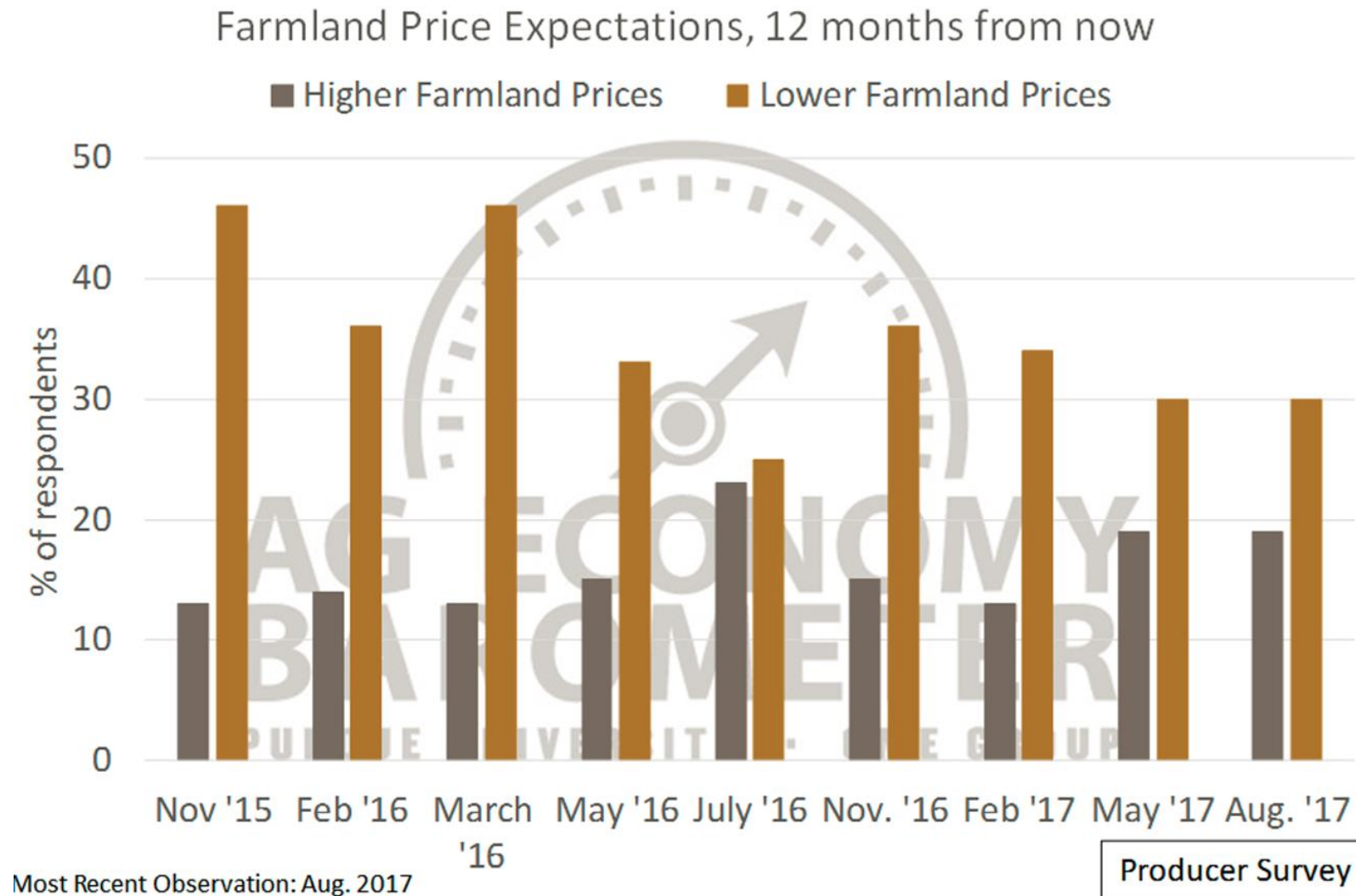




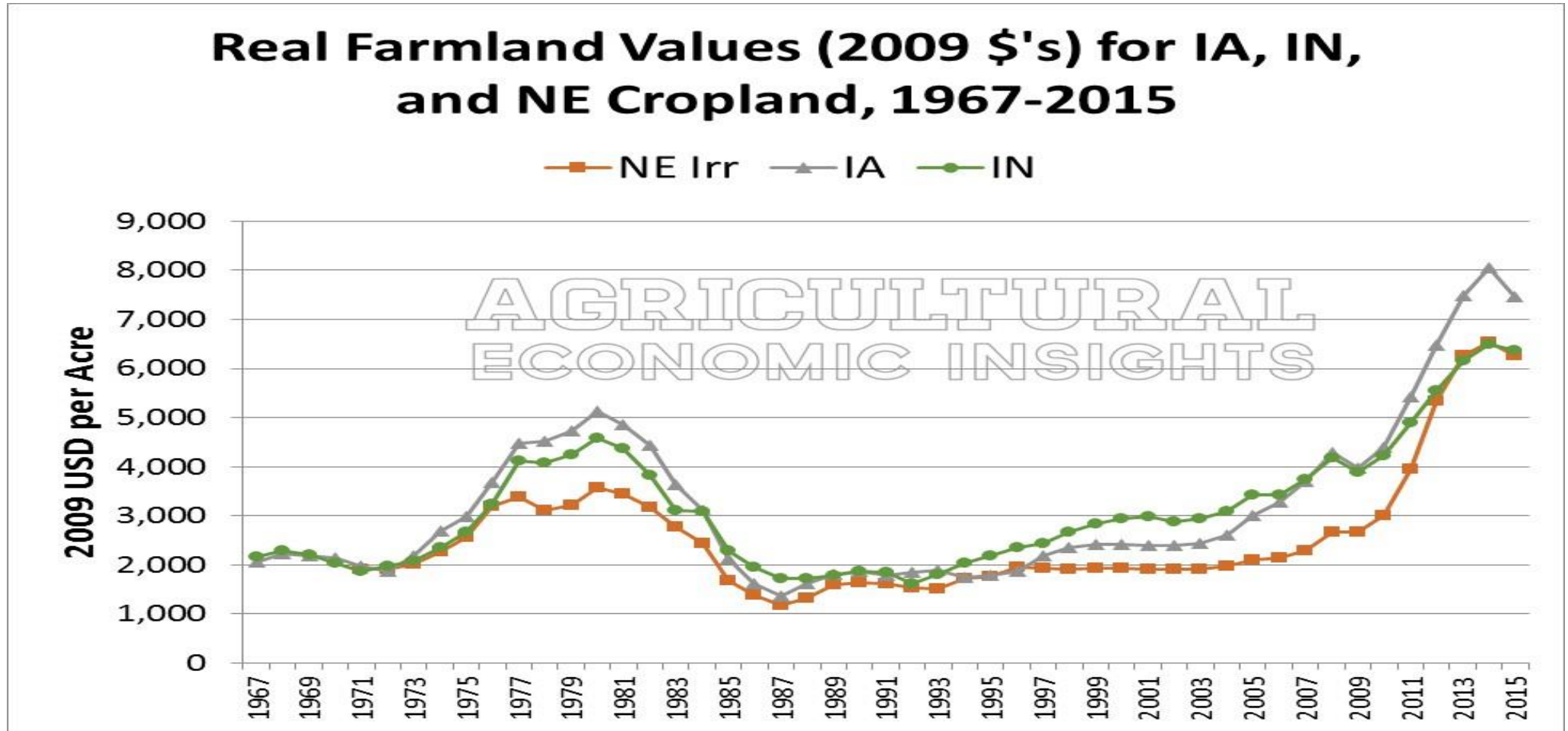
Farmland Values



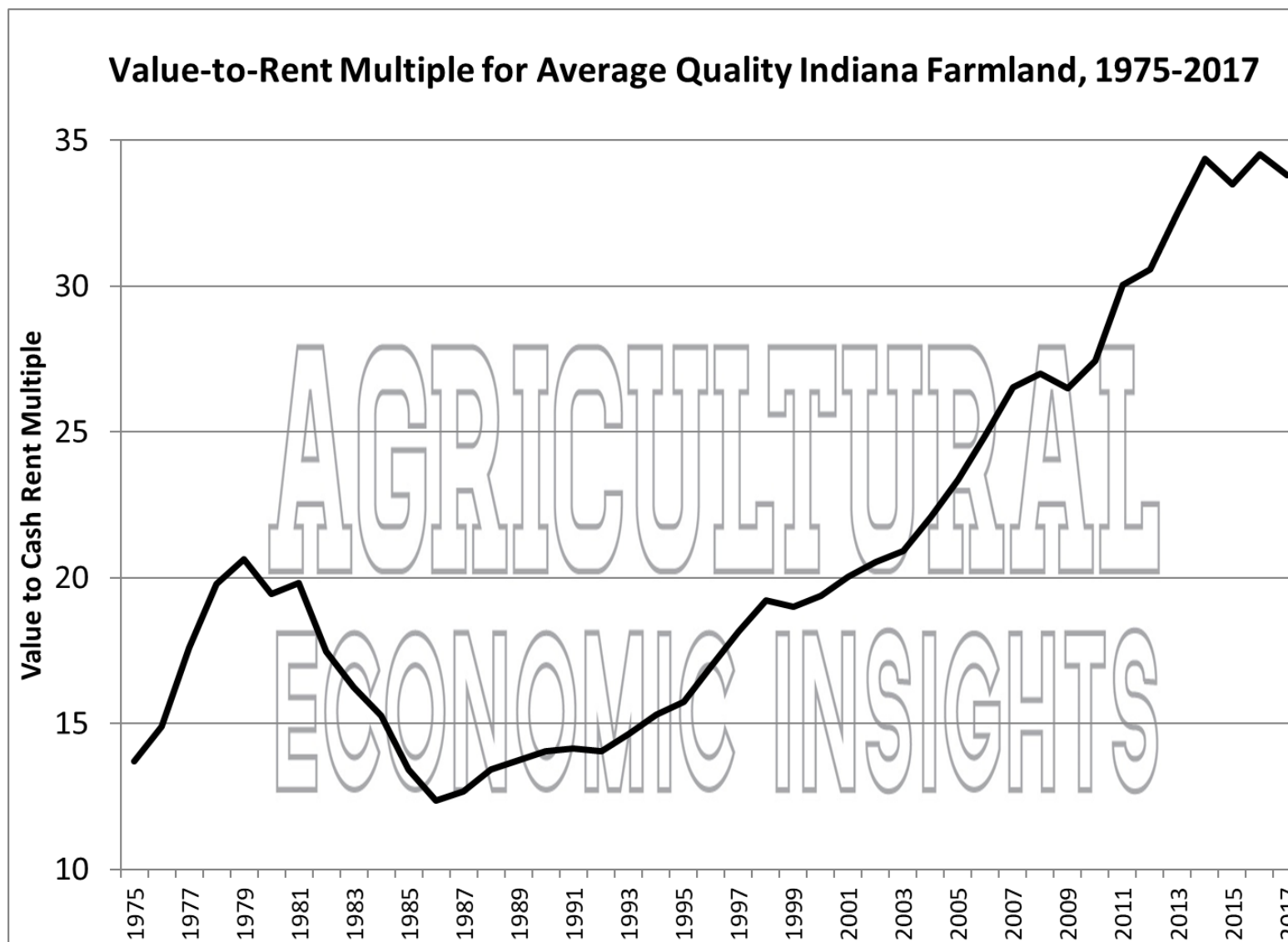
Farmers Expectations for Farmland are Starting to Trend Upward



Farmland Values are Off the Peak



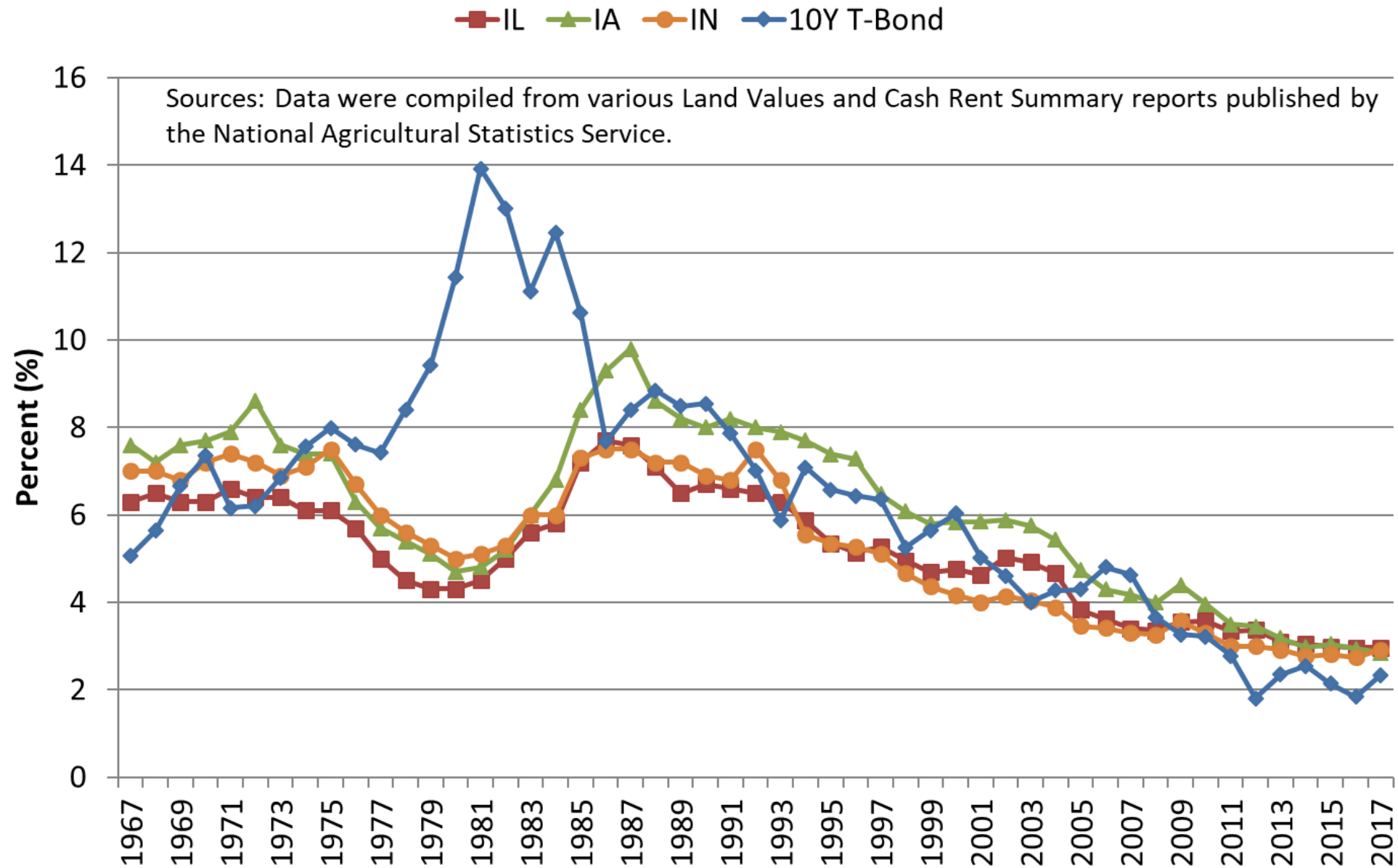
Yet, Farmland Remains Pricey Relative to Earnings





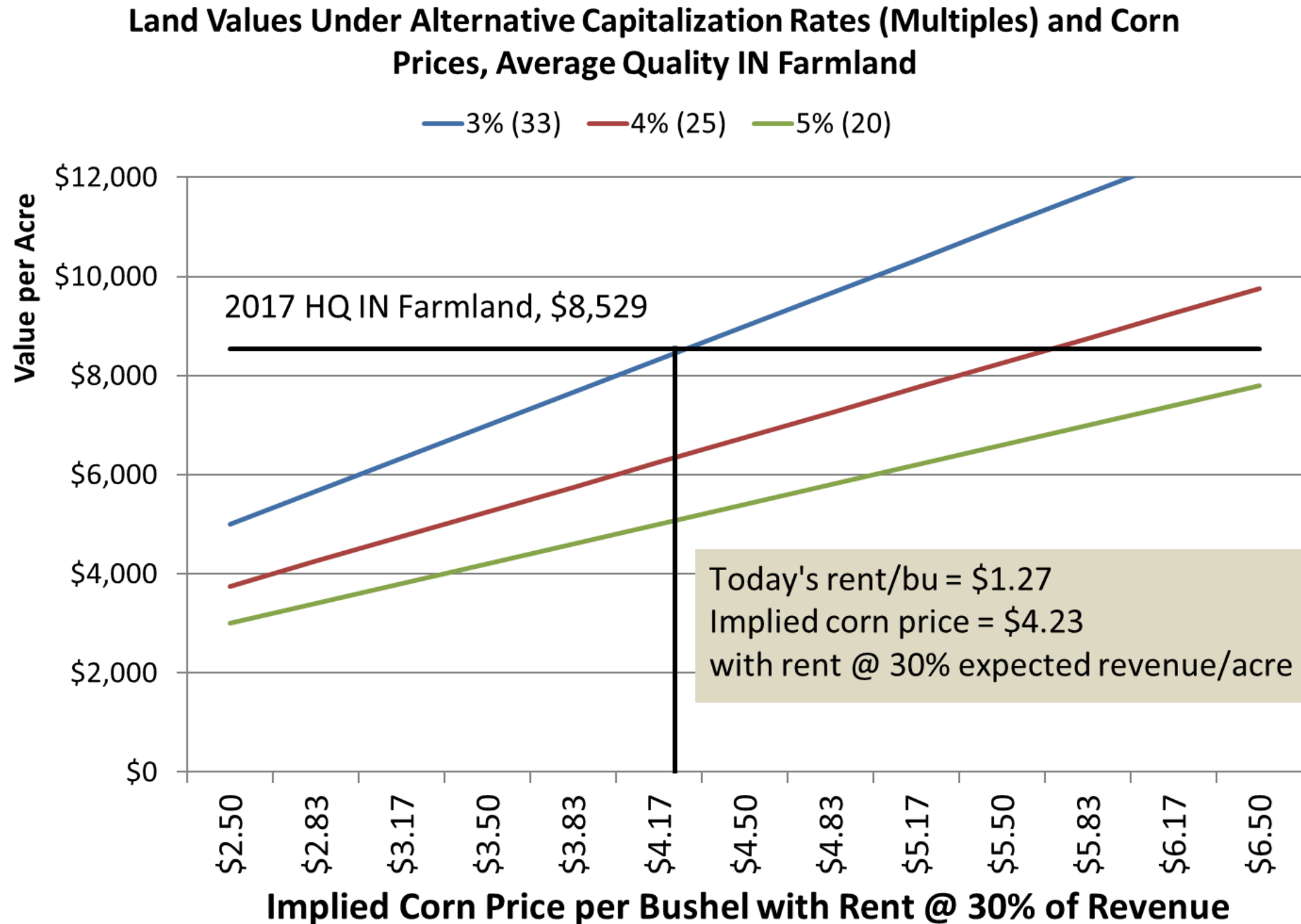
Low
Interest
Rates
Provide
Some
Support for
High
Multiples

Farmland Capitalization Rates and Interest Rates on 10 Year US Treasury Bonds, 1967-2017



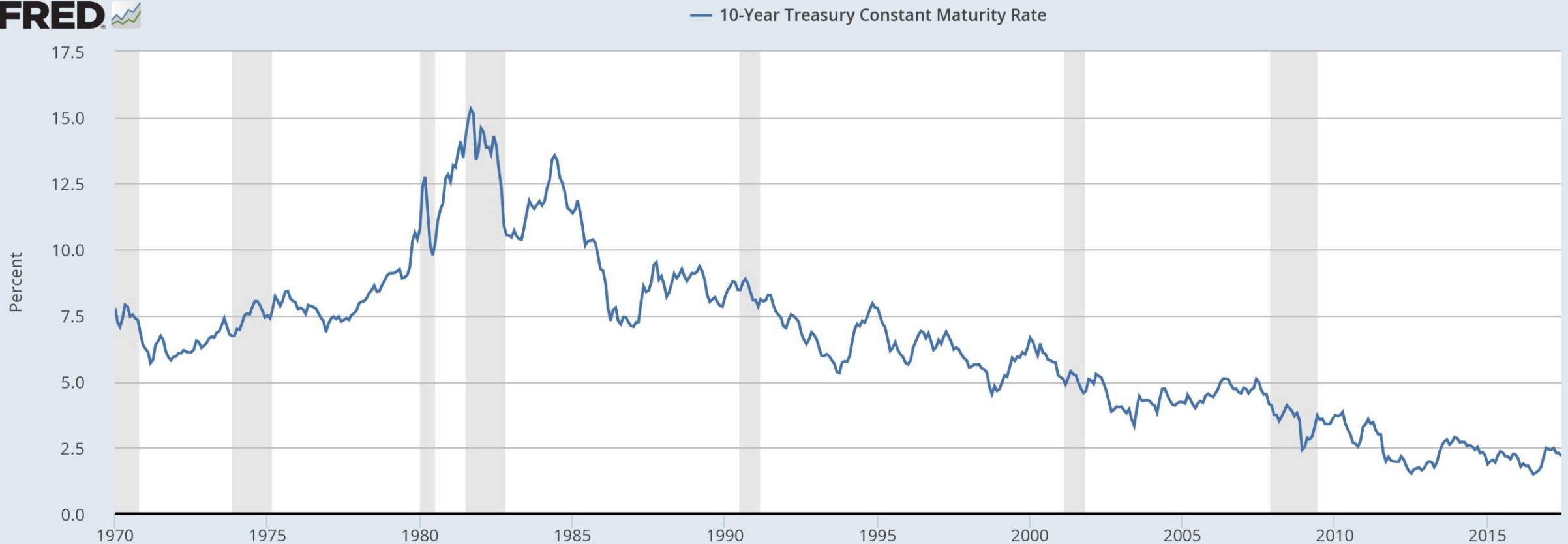


Market
appears
to be
pricing
\$4.20
corn and
standard
margins



Long-Term Rates Still Low in Historical Context

FRED



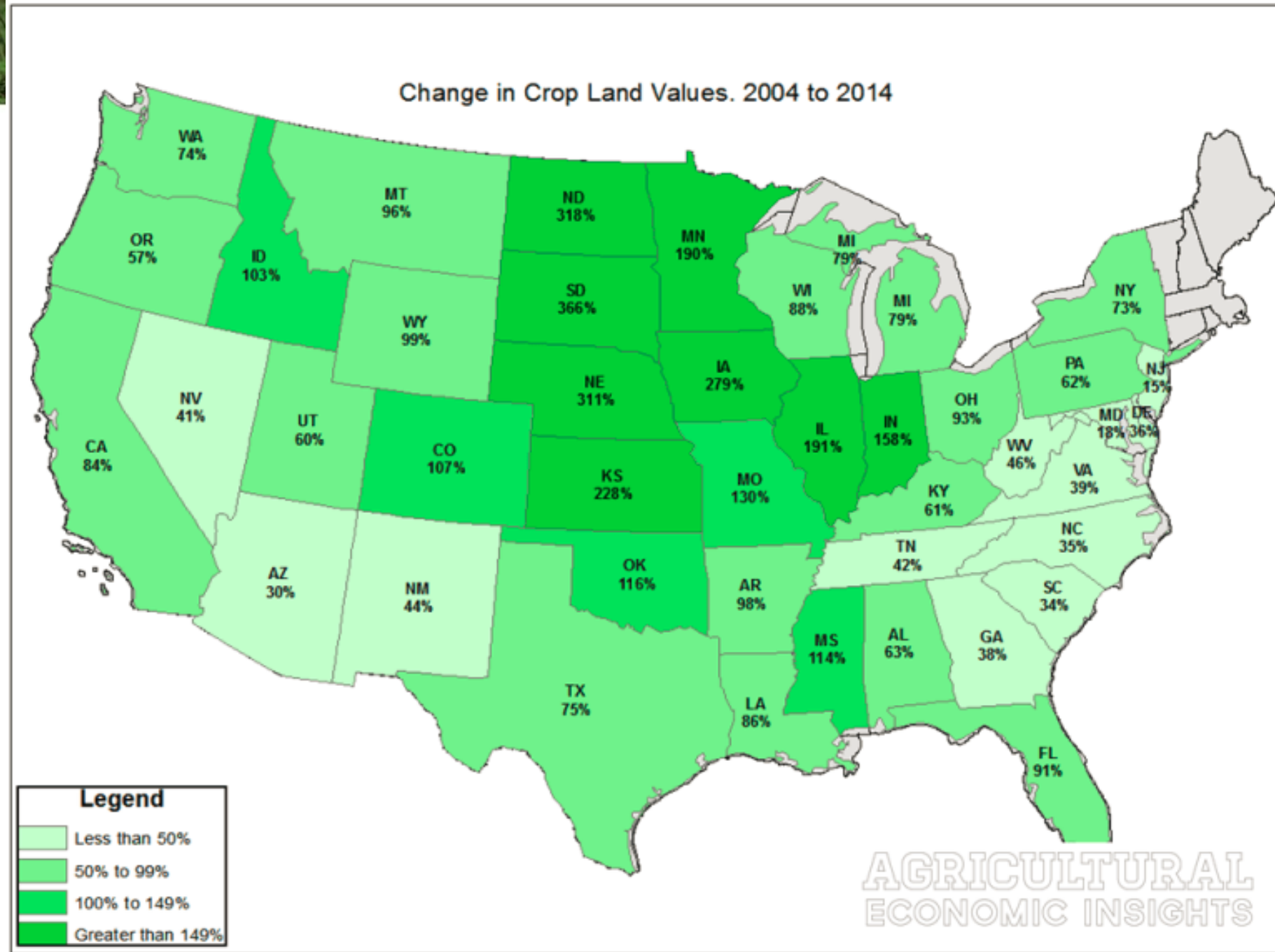
Source: Board of Governors of the Federal Reserve System (US)

fred.stlouisfed.org

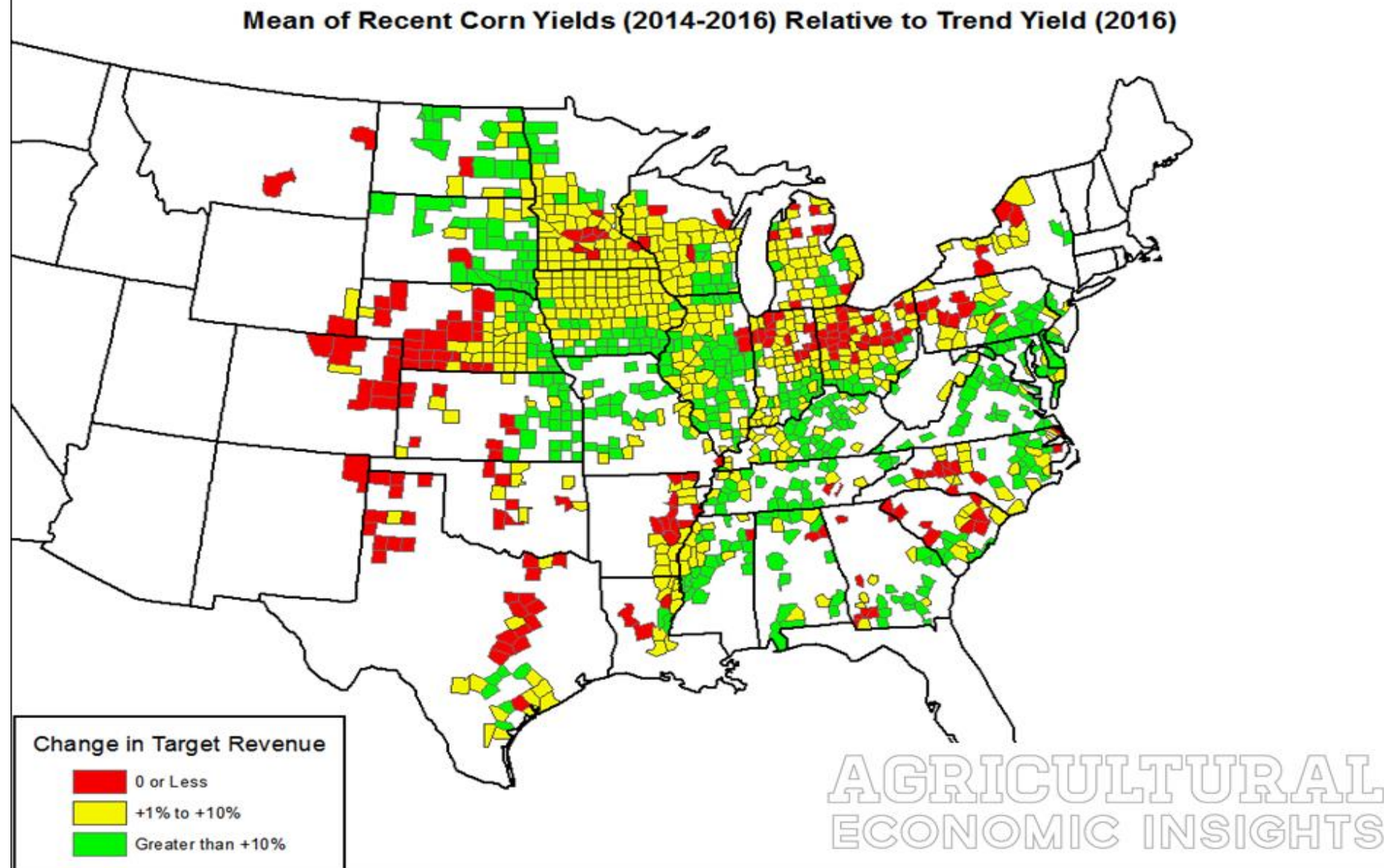
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Who Is Most At Risk?



Which Areas Haven't Had Big Yields?



Which Conditions Describe Ag Markets?*

Factor	Conditions	
Economy	Vibrant	Sluggish
Outlook	Positive	Negative
Lenders	Eager	Reticent
Interest rates	Low	High
Investors	Optimistic	Pessimistic
	Sanguine	Distressed
	Eager to buy	Uninterested in buying
Asset owners	Happy to hold	Rushing for the exits
Sellers	Few	Many
Markets	Crowded	Starved for attention
Recent performance	Strong	Weak

**The Poor Man's Guide to Market Assessment – Adapted from The Most Important Thing: Uncommon Sense for Thoughtful Investors, by Howard Marks