Current Farm Policy Studies

UNIVERSITY OF MISSOURI COLLEGE OF AGRICULTURE

AGRICULTURAL EXPERIMENT STATION

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CIRCULAR 298 Columbia, Mo. MARCH, 1945

We Could Prevent Land Price Inflation in Missouri

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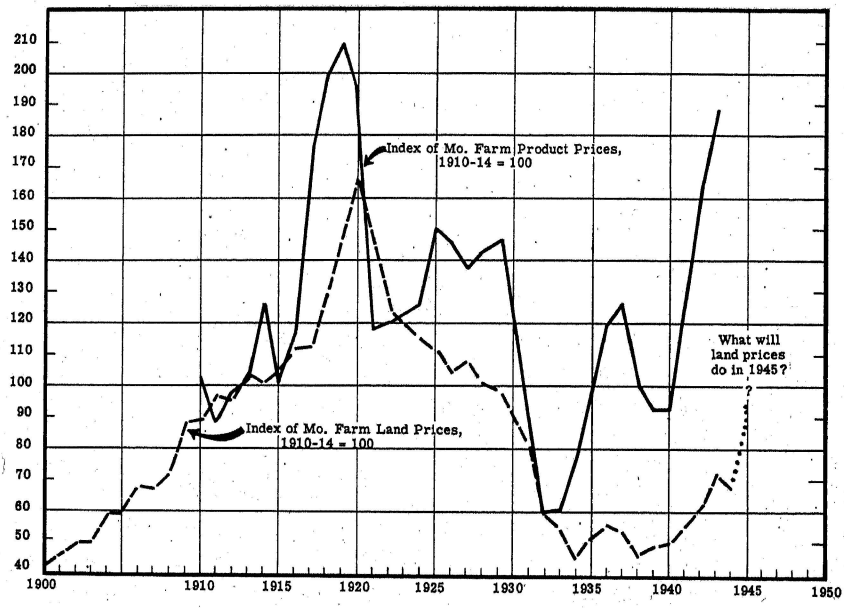

Fig. 1.—Trend of Missouri farm land prices, 1900-1944, and Missouri farm products, 1910-1943.

Farm land prices are already seriously inflated in some parts of Missouri and are approaching a dangerous inflation point in others.

A study of Figure 1, showing the index of land prices in Missouri from 1900 on up to the present, will reveal that the 1910-14 level

which is taken as 100 was at the upper edge of what might be regarded as a land price zone that could be sustained over a period of years without a permanent rise in the price level for farm products.

The Present Farm Land Price Situation

In 1933 the average sale value of land in one of our most productive Missouri counties was $60 per acre. This was the low point in land prices since before 1910. By 1941 it had recovered to an average of $77. This was still below the 1910-14 level. It is estimated that the average price in this county for 1944 is between $110 and $120 per acre.

If land prices had not gone above the 1910-14 level in so many instances, there would not be serious cause to worry about inflation; but this does not seem to be the case. There are too many cases being reported where land prices, particularly in the medium to lower land-price scale, have doubled since 1939. There seem to be several influences at work which will tend to cause further material increases. This is the dangerous aspect of the situation. Lands, which in the past with non-wartime prices have generally changed hands at from $10 to $40 per acre, are now in several instances being sold at twice these figures. There is little prospect that such a price can be justified in the long-run unless public price policies support a materially higher price level in the future.

When are Land Values Inflated?

Proper and justifiable farm land prices are those which the prospective **future net income** from the land will justify and **not** what present or immediate past net land income would indicate. If prices of farm products which may be expected in the next 20 to 30 years are applied to the land's share of the usual production of a particular farm, this will give a normal expected **gross rent** from that farm. Deducting cost of ownership will give **net rent.** Multiplying this net rent by 20 or 25 will give the approximate productive value of the farm with interest rates of 5 or 4 per cent respectively. This would give somewhere near a proper present value of a farm for an operator.

For illustration, in the county referred to above the average net rent income from farms for the period 1910-14 was $5.34 per acre. Multiplying this by 20, which assumes a 5 per cent rate of interest, will give $106.80 as a normal value per acre for farms of average production in that community under 1910-14 price conditions. The actual sale value of farms in that community at that time was $110. In other words, the justifiable value derived by using net rent and the actual sale price were practically the same; but by 1920 something

had happened to land prices. Current net rent in 1920 was $8.36 per acre, an increase of 57 per cent. If early 1920 farm product prices and costs of land ownership could be expected to continue indefinitely, and if money is worth 5 per cent interest when invested in land, the land should have been worth $167 per acre. Actually it was selling for more than $200. The major reason for this was that in 1918 and 1919 net rents had risen to about $12 per acre. Farmers were allowing these **immediate past rents** to influence their judgment of land values far beyond what **prospective prices and net rents could** possibly justify. One year after 1920 many farmers found themselves definitely embarrassed, some even facing foreclosure. Beginning in 1928 and 1929, a similar though more serious experience was encountered. The lesson of 1921 was not well learned. In 1934 there were many cases where federal aid was invoked to relieve some from error of judgment committed in 1929 or earlier.

One may, therefore, with safety say that when land prices go very far above the price indicated by estimating average future net rent and multiplying that rent by 20, purchasers are in danger of encountering declining land prices and foreclosure if a considerable part of the purchase price must be borrowed to finance the purchase of a farm. There are areas in Missouri today where farm land prices, while not more than 10 or 12 times present net rents, are 25 or 30 times the most probable long-time net rents. **This is inflation,** and it is encouraging further bidding up of land prices, again because buyers are inclined to capitalize present net rents or those received last year in estimating what land is worth rather than to try to estimate what future rents are likely to be and then act upon that information.

An illustration of inflated land prices is found in some of our cotton counties. Prevailing prices in this area are largely the result of assuming that cotton from now on will continue to sell for 20 cents per pound or more. If one would figure what the land will be worth with cotton prices during the next 20 years at 10 to 14 cents a pound, there might well be a revision of the assumption as to what the land is really worth. Our cotton counties are used here because they present a good illustration of the danger we are facing. There are several other parts of Missouri where land prices have gone far beyond the limits for long-time safe land values.

One Cause of Inflation Is Rise in Farm Product Prices

The most immediate cause of inflation in land prices is an extended rise in the prices of farm products without corresponding rises

in costs of producing those products. Farm product prices have now been rising without interruption since 1940. Whenever such improvement in farm product prices extends over more than a year or two, it usually results in a strong movement to bid up the price of lands producing those products. Prior to the First World War product prices rose without interruption from 1915 to early 1920. These rises are usually faster than associated costs, so that the net return to land is abnormally high. If future product prices were to remain at the present level, the price of farm lands could safely increase in many neighborhoods more than they have already risen.

The Cost of Owning Land Has Increased

The cost of owning land since 1910-14 has increased considerably. Taxes, costs of maintaining the soil, keeping improvements in repair, and increasing the effectiveness of those improvements, all cost more than in the 1910-14 period. These increases in costs vary from farm to farm and from community to community, but they have the effect of making necessary a price level higher than that from 1910-14 if we expect to maintain land values at somewhere near the 1910-14 level. There is no definite prospect that costs of owning land will decline. They are likely to go the other direction.

Operating Capital Requirements Are of Increasing Significance

Farmers are finding it necessary to expand the use of equipment and shelter for that equipment, and to give more attention to labor-saving devices in handling livestock, all of which is tending to increase the outlays for improvements on farms or for capital to operate the farm. They are also confronted with increased necessity for making extensive repairs or replacements to improvements and livestock handling facilities. All of this means that many of the farms now being purchased by new operators will require additional investment to put them in first class operating condition. By the time the farm unit is in good operating condition, this will make the actual investment in a farm purchased now higher than the purchase price indicates.

Owner Equity and Not the Mortgage is Affected by Land Price Change

Any slight indication that land values are rising seems to make prospective purchasers forget that while their equity in the farm expands as prices rise, it must just as certainly take all of the shock when prices fall. For illustration, a moderately productive farm purchased with land prices seriously inflated might look as follows:

At present time:	
Purchase, 160 acres @ $150 per acre	$24,000
Down payment of buyer (owner equity) 40%	9,600
Mortgage for the balance, 60%	14,400
After deflation:	
Value of farm, 160 acres at $100 per acre	16,000
Mortgage debt still unpaid	14,400
Owner Equity	1,600

This illustrates how the amount of the mortgage is unaffected, although owner equity may shrink to a danger point or completely disappear. The process of deflation may wipe out an owner's entire savings. Neither inflation nor deflation will affect the size of the mortgage. All of the change must be absorbed by the operator's equity.

No Permanent Gain Results from a Period of Inflation and Deflation

Only the attorneys, the abstract offices, and recorders seem to get even temporary benefits when a community passes through a period of inflation and deflation. Actually these apparent winners suffer because of unemployment and suffering in the community, with hardship and loss of business among all their neighbors.

When a farmer sells a farm at an inflated value, expecting to buy another farm at a lower figure, he usually finds that he either buys a poorer farm at about the same figure or a similar farm at a higher figure, and goes into debt for the difference. If one expects to continue farming, there is seldom a significant gain realized from selling—even at a high price—the present farm with which he is well acquainted and expecting to buy at a more advantageous price a better one with which he is not acquainted. Before signing a sale contract for his farm, the owner should already have a better farm located and the price for the new one agreed upon. Very often he may be only changing farms at no advantage, and increasing his debt burden. It is **debt** which gets a farmer into trouble in the deflation period which usually follows a land boom.

A Doubtful Time to Buy

The near future is not likely to prove a favorable time for tenants to acquire farms at present price levels, or owners to add acreage to present holdings just because current farm incomes happen to be more liberal. These available funds can be held in war bonds or other safe investment, and will most likely buy more or better acres four or five years from now.

Unless some means is developed to keep farm product prices from falling, there will inevitably be deflation of farm land prices following

periods of inflation. There is one way to avoid the disastrous consequences of an inflation-deflation experience, namely, avoid buying land on credit. Paying cash for a farm at inflated values implies a willingness to see the market value of that farm decline to less than the purchase price when deflation comes.

What Should be the Future Price Level for Farm Land?

The future price of farm land in Missouri will be determined largely by what happens to the inflationary forces already mentioned. If farm product prices remain somewhere near their present level, land prices will rise until the net return from land is again about normal and then remain at that level. If one could tell what changes will occur in the price level, then one could tell approximately what a reasonable future price of land would be. The cost of ownership will also affect the future price of land, because this cost affects the net rent realized from owning land. As has been indicated, ownership cost is tending to rise. As nearly as can now be seen, the most probable level of farm commodity prices will be 20 to 25 per cent below present commodity prices. Reasoning from this, it will mean that farm land prices which are now influenced by the present high level of product prices will not be maintained, and recession from this level will be inevitable. If prices do recede 20 to 25 per cent below present levels, we may expect land prices more nearly like the 1942 level.

Operating Capital Increasing

A further factor which is slowly affecting land value is the increasing emphasis necessary to place on operating capital as compared with real estate capital. Without some means by which farmers' total capital can be increased, any increased need for operating capital must come out of that portion of the farmer's savings which would ordinarily be devoted to real estate. Table 1 and Figure 2 show what has happened in twenty years to the division of the farmer's capital between real estate and operating capital. There is a gradual growth of the proportion which must be used for operation and a shrinkage of that represented in the value of the farm. This means that every time a farmer estimates what he can pay for the land, he must make greater allowance for operating capital. He will, therefore, tend to bid less for the land on which that operating capital is used. Most farmers are now under-supplied with operating capital. Many of our Missouri farms would be more efficiently operated if they had double the present operating capital.

The machinery required to do a good job of farming the land and get the work done with less labor expense is constantly increasing. With public policies regarding wage rates as they are, farm operators can scarcely afford not to have a maximum of labor-saving machinery and power. This will have an effect on long-time land prices.

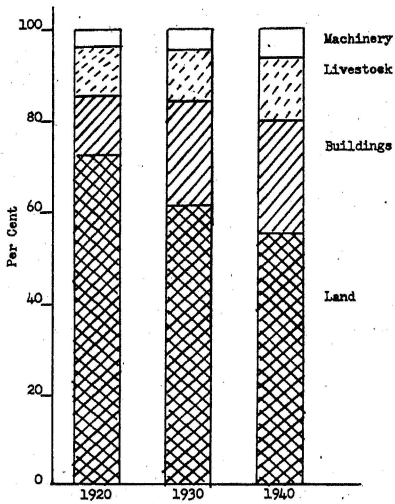

Fig. 2.—Percentage distribution of capital on Missouri farms. (From U. S. Census.)

TABLE 1.—TREND IN THE DISTRIBUTION OF THE MISSOURI FARMER'S INVESTMENT 1920-40.
From U. S. Census

Capital class	Percentage of total capital per farm 1920	1930	1940
Land	72.2	61.2	55.1
Buildings	13.1	22.9	24.9
Total real estate	85.3	84.1	80.0
Livestock	10.9	11.5	13.7
Machinery	3.8	4.4	6.3
Total operating capital	14.7	15.9	20.0

Other Factors Affecting Land Prices

There are now additional bullish land price factors. There will undoubtedly be continued demand for small tracts of land for part-time farm operation, self-sufficing units for some returning Service men, and acreage to supplement disability allowances of those Service men disabled in action. Some of these smaller units will no doubt be permanently separated from commercial farming activities. Others provements which will be comparatively valueless to the commercial are more likely to be temporarily separated and equipped with im-farming operators who will in the next three to five years be expected to repossess these acreages. Disappointment of amateur operators on these small units is certain to result in many cases. While this particular group constitutes an inflationary influence when they purchase these lands, their departure from this frequently unfortunate venture will have a deflationary effect a little later.

Other investment possibilities affect land values. At the present time men in other vocations are putting money into farm lands.

Immediate earnings prospects are superior to those other investments seem to offer. This will tend to hold farm land values up, but if and when other investment possibilities appear many of these purchases will be re-offered to actual farm operators and constitute a bearish item.

The purpose here has been not to forecast exactly what is going to happen to land prices, but to emphatically warn prospective farmer purchasers that net returns during the next twenty years can scarcely be expected to be as favorable as they are today; and, therefore, emphasizing present rents in determining what can be paid for a farm is quite likely to result in disappointment or disaster unless the purchaser can pay practically the full amount in cash at the time of purchase and be willing to see a considerable part of this payment disappear when land prices once more settle back to a level justified by long-time prospective net rent income.

Voluntary Control of Land Prices is Preferred

Farmers can themselves exercise control over land prices if they are willing to do so. There is a growing impatience with the inclination of people to gamble in land values when rents temporarily increase. Such gambling has meant loss of savings, suffering and disaster to too many people. If voluntary control is not exercised, keeping land prices more nearly on a rational level, we have assurance that federal contols will be applied. These controls promise to go to whatever length is necessary to prevent the disaster experienced in 1934. It might even go so far as to put price controls on lands and allow transfers only by permit. This is regarded as a highly undesirable alternative. The only way such a move can be avoided is by exercising voluntary control through refusal on the part of buyers to bid up the price of land and lenders to boost appraised values unless its long-time earnings prospects will justify such increases. The temptation on the part of the individual investors to make a quick killing is great. While they have resisted with fair success up to the present moment, lending agencies, in competition for loans, are now moving in the direction of higher farm land appraised values.