

The Wisconsin Farm Real Estate Market: The Prospects For More Gains In Farm Real Estate Values

**By Bruce L. Jones, Director
University of Wisconsin Center For Dairy Profitability**

July 1997

Recently it was reported that Wisconsin farm land values increased 14 percent in 1996. This rather robust increase in land values comes on the heels of a 9 percent jump in land values in 1995. Some persons view these increases in farm land values as signs that the land market is strong and positioned to yield some excellent gains to those who are willing to invest in farm real estate. Others, including this author, are concerned that these recent increases in land values are signs that the speculative forces that drove farm land markets in the early 1970s may be reappearing.

Historic Trends In Real Estate Values and Net Farm Income

Economic theory, and for that matter common sense, suggests that farm land values should be positively related to farm income levels such that land values rise as farm incomes increase and fall when farm incomes decline. This positive relationship between farm land values and farm incomes has existed through the years, as is shown by Figure 1.

From 1950 to around 1978 Wisconsin farm land values moved steadily upward as net farm income rose to successively higher levels. This positive relationship between land values and net farm income over nearly 30 years is evidence that farmers were generally willing to bid higher prices for farm land as the income generating capacity of this key farm asset rose.

Around 1978 or so, the Wisconsin farm land market quit behaving as it had during the 1950-1978 period such that farm land values no longer moved in concert with net farm income. Rather farm land values tended to move upward while incomes were falling and then land values fell as farm income levels were generally rising. This reversal in the relationship between farm land values and farm incomes is evidence that factors other than farm incomes have been driving Wisconsin farm land since the late 1970s.

Figure 1 clearly shows during the 1978-1983 period farm income was on a downtrend. While farm incomes were falling, farm land values were either rising or holding relatively steady. The accepted explanation for this occurrence is that farmers' expectations about farm incomes were not in line with what actually happened. Farmers were apparently convinced that farm income levels would rebound and continue to trend upward as they had over the previous 30 years. They

held fast to these rather optimistic expectations about farm incomes even though incomes were clearly moving downward. As a result of this rather optimistic expectation about incomes, land owners continued to bid up the price of land even though farm incomes fell steadily for roughly four years.

During the 1984-1989 period, farmers finally saw their incomes rebound and steadily increase. The one exception was the year of 1988 when farm incomes fell as a result of drought conditions. This uptrend in farm incomes was welcomed by financially-strapped farmers but it did not trigger an immediate turn-around in farm land values. Instead farm land values dropped at rather alarming rates during this period when farm incomes were on the rise.

Figure 1 shows that during the 1984-1989 period farm land values generally declined and then held steady while farmers' incomes rose. This decline in farm land values was, in part, a valuation adjustment that was precipitated by decreases in farm incomes in the preceding period. The decrease in farm land values was also the result of a major increase in the supply of farm land that was offered for sale in the period.

During the mid-1980s a considerable number of farm businesses were going through bankruptcies or experiencing severe financial difficulties. These financial problems forced many farmers and lenders to put farm real estate on the market. This abrupt increase in the supply of farm land for sale put some major strains on farm land markets that ultimately translated into much lower land values. As a result of these price adjustments many farm real estate owners incurred some substantial financial losses.

Around 1989 or 1990 another reversal took place in the Wisconsin farm land market. Having bottomed out in the last half of the 1980s, farm land values started trending upward again as they had during the 1950-1978 period. This recovery in farm land values strengthened the financial positions of farmers who own land. More importantly it has helped farmers cure the financial ills that dogged them much of the 1980s.

Current Situation

To some, the current uptrend in farm values is a signal that the Wisconsin farm land market has stabilized. This may be the case but there are other persons who believe the stage is set for another downward correction in the farm land market. This somewhat pessimistic belief is based on the fact that net farm income per acre has been trending downward since 1990. This decline in earnings is easily seen in Figure 1.

The recent declines in farm income could very well be a precursor to another round of price adjustments in the farm land market. In the previous decade, decreases in farm income were followed by some declines in farm land values. Both history and economic theory suggest that the Wisconsin farm land market is again set to go through this type of adjustment.

There is a chance that Wisconsin farm land values will not be dropping as a result of the recent

decline in farm incomes. Land values could hold or even continue to rise if there is an increase in the demand for nonfarm uses of land such as housing, manufacturing, mining, recreation, etc. These nonfarm demands for land could offset the downward pressures that falling farm incomes would put on farm land values. However, it is very unlikely that nonfarm demands for farm land will be the major driver of the Wisconsin farm real estate market. The key determinant of farm land values will continue to be farm incomes. Thus we should not expect nonfarm demands to keep farm land values from falling when incomes are on the decline.

Conclusion

The comments made in this paper are not intended to scare anyone or warn people of an impending collapse of the farm real estate market. However it is hoped that this paper will make people realize that the strong gains in real estate values that have been observed in the last couple of years have not been driven by income gains. This is a very important point because it means farm land values should not be expected to keep rising in the near future. The bullishness of the farm land market could evaporate rather quickly if farm incomes do not turnaround substantially in the next couple of years. Persons interested in purchasing farm real estate should be aware of this fact and not get drawn into the trap of assuming that farm land values must go up. There is little to prevent land values from falling; especially when farm incomes have been on a downtrend the last few years. Persons in the farm land market should always remember that it is income that ultimately determines the value of farm land.