



Ag Decision Maker

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Cash rental rates up again, but slowing down

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Anyone who is involved with the rental market for Iowa farmland knows that rental rates have been pushed higher by the favorable corn and soybean prices that farmers enjoyed in 2007 and 2008. How-

ever, lower prices in late 2008 and 2009 seem to have taken much of the steam out of the land market. Results from the most recent Iowa State University Extension survey estimated that the average cash rent for corn and soybean land in the state for 2009 was \$185 per acre, \$8 per acre higher (4.5 percent) than in last year's survey. This compares to an increase of \$27 per acre (18 percent) from 2007 to 2008.

The intent of the ISU survey is to report typical rents in force, not the highest or lowest values heard through informal sources. Rental values were estimated by asking over 2,000 people familiar with the land market what they thought were typical rates in their county for high, medium and low quality row crop land, as well as for hay and pasture acres. For 2009 a total of 1,271 responses were received. Of these, 39 percent came from farmers, 27 per-

cent from landowners, 11 percent from professional farm managers, 15 percent from lenders, and 9 percent from other professionals.

The most positive factor affecting rents has been higher grain prices. Consistently good yields in recent years have also lent support. On the negative side, escalating costs for fuel, fertilizer, seed, pesticides and machinery have offset some of the higher revenues. Wet, cool weather and flooding in some part of Iowa may have dampened competition for rented land for 2009, as well. There was evidence from

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Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Change in Corn Prices by Two Week Period, 1999-2008 – A2-17 (1 page)

Change in Soybean Prices by Two Week Period, 1999-2008 – A2-18 (1 page)

Joint Machinery Ownership – A3-34 (3 pages)

Change in Hog Prices by Two Week Period, 1999-2008 – B2-15 (1 page)

Change in Cattle Prices by Two Week Period, 1999-2008 – B2-20 (1 page)

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the survey that the higher average rents came about mostly from renegotiation of leases that had not been changed for several years. On the other hand, many of the higher rental rates either stayed the same or were lowered slightly for 2009.

Other resources available for estimating a fair cash rental rate include Ag Decision Maker information file C2-20, "Computing a Cropland Cash Rental Rate," and file C2-21, "Flexible Farm Lease Agreements." Both of these include decision file electronic worksheets to help analyze leasing questions.



Farm bill and leasing meetings information

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Informational meetings were held throughout the state this spring to cover provisions of the 2008 Farm Bill. This summer, meetings will continue to address new sign-up dates, rules, and other regulations that have been finalized in recent weeks. The meetings will cover payment limitations, current Direct and Counter-Cyclical Program (DCP), the new revenue component known as the Average Crop Revenue Election (ACRE) program, and the new permanent disaster program (SURE).

The meetings are intended to assist landowners and operators in their decision whether to enroll in the new ACRE program or stay with the current DCP. ISU Extension ag business field specialists will discuss revenue features of the ACRE program. The Ag Decision Maker ACRE decision tool will be presented to show projected revenue and payments. Meetings will last approximately two to three hours.

Meeting times, locations, and registration information are included on the AgDM meetings page (<http://www.extension.iastate.edu/agdm/info/meetings.html>), and new locations will be added as they become available. Information Files and updated Decision Tools for the 2008 Farm Bill are available on the Ag Decision Maker Farm Bill page (<http://www.extension.iastate.edu/agdm/info/farmbill.html>). Decision Tools are updated frequently to correct for new price information or rule adjustments that have been made.

Farmland Leasing Workshops

Farmland leasing workshops are also being held during July and August. Workshops are designed to assist landowners, tenants and other agri-business professionals with issues related to farmland ownership, management, and leasing agreements.

Each workshop attendee will receive a set of useful materials about farm leasing arrangements. Workshops will last approximately three hours and will be led by Iowa State University Extension farm management specialists.

The Leasing Meetings page (<http://www.extension.iastate.edu/agdm/info/meetings2.html>) lists available meeting dates, locations, and registration information. Locations will be added as they become available, or contact the local county extension office to find the nearest meeting location. The Leasing section of AgDM also provides useful materials for negotiating leases, information on varying types of leases, and lease forms.

Knowing the latest information and where to find the best resources will make decisions easier for you and your clientele. Look to ISU Extension and Ag Decision Maker for information and decision tools this summer.

Switching to organic pork production has potential advantages and drawbacks

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As the market for organic products continues to increase, some pork producers might want to consider a change to that type of production. Research results from the Organic Trade Association show sales of United States organic products, including pork, grew more than 17 percent from 2007 to 2008, and the consumer demand is expected to continue despite the current economic downturn.

Iowa State University (ISU) animal science professor Mark Honeyman said consumer desires can lead to increased demand for organic pork products.

“Many U.S. consumers of pork are interested in issues concerning the environment, food safety, pig welfare and pig farm ownership and structure,” Honeyman said. “These consumers may be willing to pay more for pork from farmers who also are concerned about these issues.”

Consumers typically pay more for organic pork, primarily because organic pork costs more to produce. This increased price tag is at least partially due to lower feed efficiency and higher feed costs in organic production, Honeyman said. As of early May, the price of organic corn is around \$8 per bushel, compared with the price of traditional corn at around \$3.50 per bushel.

Both Honeyman and ISU agricultural economics professor James Kliebenstein said there are numerous financial benefits to organic pork production, including a market segment with higher value pork that continues to grow. Socially, organic producers could have the opportunity to get to know their consumers, and may be more able to use skills and labor of more family members in the operation.

However, the change to organic production is not without its liabilities. Kliebenstein said some produc-

tion factors can negatively affect an organic producer's financial bottom line.

“The pigs per litter and litters per sow per year figures are lower, and along with a generally lower productivity, this adds to the cost of organic pork production,” he said.

Kliebenstein said producers who are considering going to organic production need to objectively and accurately assess their own situation and operation, and evaluate both potential advantages and risks.

Honeyman said the variability and consistency in organic production can be problematic.

“Organic pork production is more variable and less predictable and there are not as many tools to keep costs low,” Honeyman said. “In conventional pork, we've worked many years to keep costs low. This variability in production creates problems on the marketing side. Consumers desire a consistent quantity of fresh product.”

Honeyman said producers who want to take a serious look at switching to an organic system should consider several factors. For example, do they have a reliable source of organic feedstuffs? Is there an available and steady market for their products? Because no antibiotics are allowed, pig health can be a financial concern, as can the costs associated with organic certification and its regulations.

Producers who want to make a change in their operation, yet can't financially justify moving to an organic system might want to consider the niche segment of “natural pork.” This system allows the use of traditional feeds and de-wormers, and allows for a less drastic operational change. Natural pork has a more established market and can provide producers with a more readily available market that experiences fewer market fluctuations.



Economic state of the ag sector

By Neil E. Harl, Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University, Ames, Iowa

The agricultural sector is not an economic island. However, the global financial difficulties that have caused severe heartburn for financial firms and most of the global economy have largely bypassed the agricultural sector. It is clear that the longer the meltdown persists the more serious and far-reaching the effects are likely to be on farming and ranching and on rural areas. If investor confidence is not soon restored, credit availability could pose a significant problem for production credit, land purchases and trade in agricultural products and the world-wide demand for agricultural products would likely decline further. Moreover, rural areas have suffered lay-offs with rising unemployment, stock market losses and reduced discretionary spending in addition to the long-term adjustments that have been on-going for decades. These effects seem likely to continue for the next several quarters and, in some instances, beyond. Farming, particularly crop farming, has fared relatively better than livestock farming in recent months but storm signals are flying for crop production.

The Danger Signals

Higher commodity prices in 2007 and 2008 and modest debt levels (compared to the 1980s era) have helped the farming sector in many areas of the country avoid the worst effects of the global meltdown and have enabled agricultural lenders, in general, to maintain healthy balance sheets. But the sharp declines in commodity prices in late 2008, the economic and financial woes of the ethanol industry and the falling demand for agricultural products, especially in developing countries, are impacting the sector to a much greater extent in 2009.

Commodity demand and supply

When corn prices were hovering near \$8 per bushel, soybeans were selling at more than \$15 per bushel and wheat had skyrocketed to near \$25 per bushel in some specialty wheat markets, optimism was justified for those who believed that such price levels would continue. An unprecedented amount of net

income was bid into cash rents and capitalized into land values. But with corn dropping to the vicinity of \$4 per bushel, soybeans in the \$9 to \$10 per bushel range and wheat declining to \$5 to \$6 per bushel, there is less income to capitalize into land values. Moreover, production costs have risen, almost across the board, cutting into the net income per acre. Granted, the sharp drop in crude oil price in recent months has provided some relief on the cost front with the impact going well beyond the costs for gasoline and diesel fuel. One sobering factor on the demand side (particularly on the commodity futures markets) has been the role played in futures prices by the commodity funds. While the role of the funds in the steep run-up in crude oil prices is now fairly well established, the role of the investment funds in the dramatic climb of agricultural commodity prices (and subsequent declines) is less well accepted. Suffice it to say, it may not have been all demand and supply in the traditional sense.

As a consequence of several factors, mostly related to demand, farmland values declined in late 2008 and are expected to decline further in 2009 and, possibly, in 2010. Long-term, land prices are influenced by the net income from the farm commodities produced on the land in question. While a replay of land value declines in the 1980s is not anticipated, any decline affects credit availability, especially for the more heavily leveraged prospective purchasers.

Ethanol production

The boost in commodity prices was heavily related to the growth of the ethanol industry. The demand of ethanol plants for corn caused a run-up in the prices for other commodities competing for farmland, notably soybeans and, to a lesser degree, wheat. As of early 2009, approximately 170 ethanol plants were in production, representing roughly four billion bushels of demand for corn.

That demand appears less secure in light of the economic problems faced by the ethanol industry. More

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than 20 ethanol plants have filed for bankruptcy in recent months and several more have ceased operations for various financial and economic reasons. By some estimates, as much as 30 percent of ethanol capacity is idled or on slowdown.

The economic trauma in some instances has been partly the result of factors affecting all ethanol plants; in other situations, the economic hurdles have been more severe for recently-constructed plants. Dramatic fluctuations in the price of corn (the major input) and in the price of crude oil (which has a considerable influence on the price for ethanol) have wrenched the industry well beyond anything that could possibly have been anticipated by investors in ethanol plants. These are the two "brakes" that are faced by the ethanol industry. The steep rise in construction costs has contributed to the economic problems, also.

Several plants have been shuttered or are in bankruptcy because of ill-fated steps taken to manage risk with the hedges resulting in huge losses as the price of corn rose to record levels and then declined sharply to more normal levels.

The future of the ethanol industry depends heavily upon three factors --

- (1) the energy policy of the United States (which has been friendly to ethanol for several years);
- (2) the economics of conversion of feedstock (principally corn) into ethanol fuel; and
- (3) the emerging technologies and their competitive positions.

Ethanol is likely to merit a "place in the sun" for three to five more years. Beyond that, ethanol may well rank as a component of the package of alternative energy sources for some time in the future. Economic considerations will almost certainly be the major determinants as to which energy alternatives survive as energy sources. The energy source that can produce the units of energy needed at the lowest price and with the safety factors and reliability factors demanded by consumers will be in the driver's seat.

As for ethanol plants that are now shuttered or cannot cover their variable costs, some are likely to

be sold at a discount (currently, variable costs are roughly 90 percent of the cost of producing ethanol, leaving little for fixed costs and profit for investors). A government credit line would help to buy time but is not a viable long-term solution. In the long-term, ethanol must be a competitive source of energy to survive unless subsidies continue, mandates increase and tariffs are maintained.

Impact of the meltdown on the demand for food and fiber

In recent years, the gradual increase in per capital incomes around the world, but particularly in the low-income countries, caused a steady increase in the demand for food. The income elasticity of demand for food is high in those countries (as high as 0.7 which means that 70 percent of additional income goes for food). The increase in per capital incomes was heavily related to trade, outsourcing and globalization, with production gradually moving to areas of lowest cost production and with all manner of economic activities shifting to low wage countries, raising per capita incomes.

All of that has been affected by the global meltdown in recent months with the demand for the goods and service produced in those countries declining, in some instances dramatically. This is leading to reduced demand for food, worldwide. Most of the leading importers of farm commodities from the United States have reduced imports except for China. The rising unemployment in China will likely lead to reduced demands for food in that country as the world-wide demand for the labor intensive products produced in that country slips.

Signs of tightening credit

Depending upon how long the economic crisis persists and how deep the trauma becomes, it will clearly affect credit availability at all levels. Denial of credit in the short-run results in economic pain and the disposal of assets serving as collateral which affects asset values in the markets. Those with weak balance sheets (high debt-to-asset ratios) generally suffer the greatest. The relatively thin band of equity capital on the part of lenders makes the lenders particularly vulnerable.

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As an example, as of December 31, 2008, the Federal Deposit Insurance Corporation (FDIC) reported that 26.9 percent of the commercial banks in Iowa had two percent or more of non-performing loans. That was a 70 percent jump over a year earlier and a 155 percent increase over December 31, 2006. As of the end of the fourth quarter of 2008, 6.93 percent of Iowa banks were unprofitable compared to 4.3 percent in the fourth quarter of 2007 and 2.87 percent in 2006. About half of the banks reported non-performing loans above one percent at the end of 2008. Although agriculture is a major part of the Iowa economy, these data do not appear to reflect weakness of the agricultural economy so much as weakness in the general economy. However, with lower commodity prices and higher costs of production in prospect, the agricultural economy may be a greater contributor to lender problems going forward.

Conclusion

The economic state of the agricultural sector (both farms and ranches and rural areas generally) depends heavily on whether the world economy continues to decline. If confidence is not restored, and the financial systems continue to deteriorate, the agricultural sector will likely suffer the effects on a widespread

basis. The success of the stimulus packages and the efforts to stabilize the world's financial institutions are vitally important to the agricultural sector.

My biggest concern is that the global meltdown that is being experienced has not displayed the features of a normal economic decline. The drop in economic activity that began in late 2007 appears to be more of a "downshifting" of the economy, due principally to a revolutionary shift in thinking by consumers about debt, the likely result of companies curtailing the use of high levels of debt and the corralling of patently unwise strategies employed on a widespread basis to deal with risk. Consumers, companies and governments have all been living beyond their means. That bubble has now burst. Adjustments in economic activity promise to be profound and far-reaching as the world's economy comes to reflect a more cautious use of debt at all levels, at least for the foreseeable future. That is likely to affect the buoyancy of the general economy for several years.

**This article consists of testimony before subcommittee on General Farm Commodities and Risk Management United States House of Representatives Committee on Agriculture, Washington, D.C., April 1, 2009*

Updates, continued from page 1

Please add these files to your handbook and remove the out-of-date material.

Internet Updates

The following updates have been added on www.extension.iastate.edu/agdm.

Frequency of Profitable Hedging Opportunities for Lean Hogs, 1999-2008 – B2-53 (2 pages)

Techniques for Dealing with Difficult People – C6-50 (1 page)

Current Profitability

The following profitability tools have been updated on www.extension.iastate.edu/agdm to reflect current price data.

Corn Profitability – A1-85

Soybean Profitability – A1-86

Ethanol Profitability – D1-10

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