

# Hertz<sup>®</sup> Outlook

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## Midwestern Farmland - Strong Market, Weakening Fundamentals

The farmland market has been riding the sails of a bull market for over two years. Recently, however, the winds have started to shift. In particular, weakening commodity prices and higher interest rates are taking some wind out of the sails in farmland values.

“We came into 2023 with farmers having experienced the most profitable year of all time, with good crops and good commodity prices across the Midwest,” explains Doug Hensley, president of Hertz Real Estate Services. “But in January, the grain market started to adjust.” Brazil produced a record soybean crop and a record corn crop in 2023, on its way to topping the U.S. as the number one corn and soybean exporter in the world.

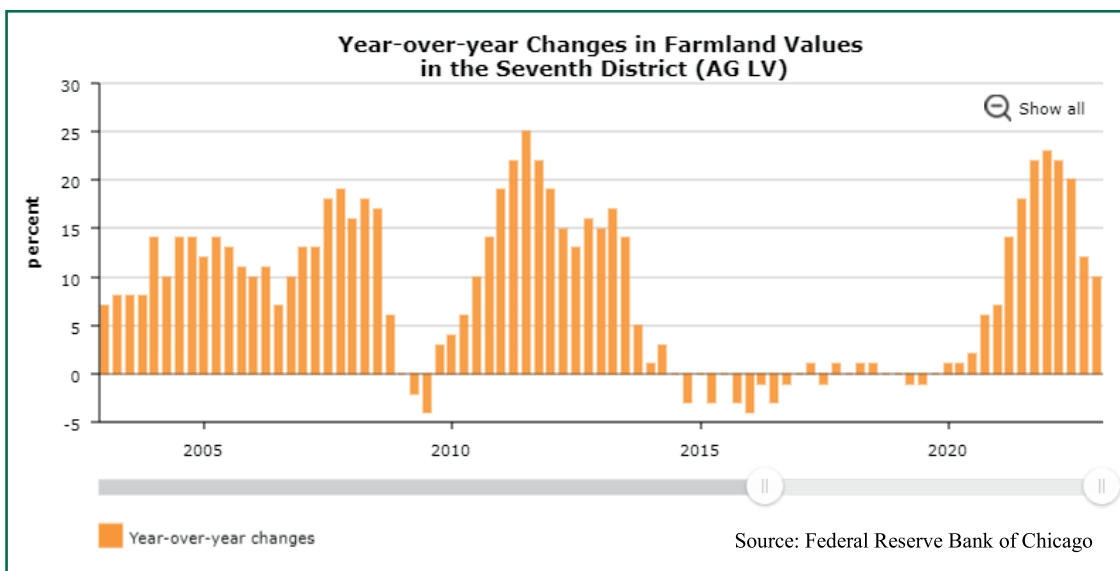
Also, the Federal Reserve has continued its strategy to raise interest rates, in its attempt to tamp down general economic inflation. While the most aggressive moves in interest rates were made in 2022, the most significant impact thus far has landed in residential and commercial real estate, reports Hensley.

“Regarding the higher rates, the farmland market hasn’t really reacted in a significant way in the first quarter of 2023,” Hensley says. “The effects

of higher interest rates were muted in the farmland sector because many buyers were spending 2022 profits. They had cash and they felt confident using it, given their financial situation. Farmland buyers have just not been borrowing a lot of money.”

“But then we got to April, and people started to focus forward on the 2023 crop, instead of what happened last year. The planting season was good overall, even if not the smoothest ever,” Hensley explains. But when farmers started to factor in current higher input costs and higher land rents, with commodity markets that had settled back, the mood changed. Farmers were more positive earlier in the spring season because 2023-crop corn futures were hovering closer to \$6 per bushel. But by late this spring, new crop corn prices dropped as much as a dollar per bushel, close to \$5 per bushel. Likewise the soybean market has given up \$2 to \$3 in the last 90-120 days. USDA is forecasting the average price received by soybean farmers to be \$12.10 per bushel in 2023-24, down from \$14.20 per bushel in 2022-23.

“We may have already seen the low in the market



### Inside This Issue

**Pg. 2:** Farm Interest  
Rate Levels

**Pg. 2:** Values Stabilizing

**Pg. 4:** Recent Sales

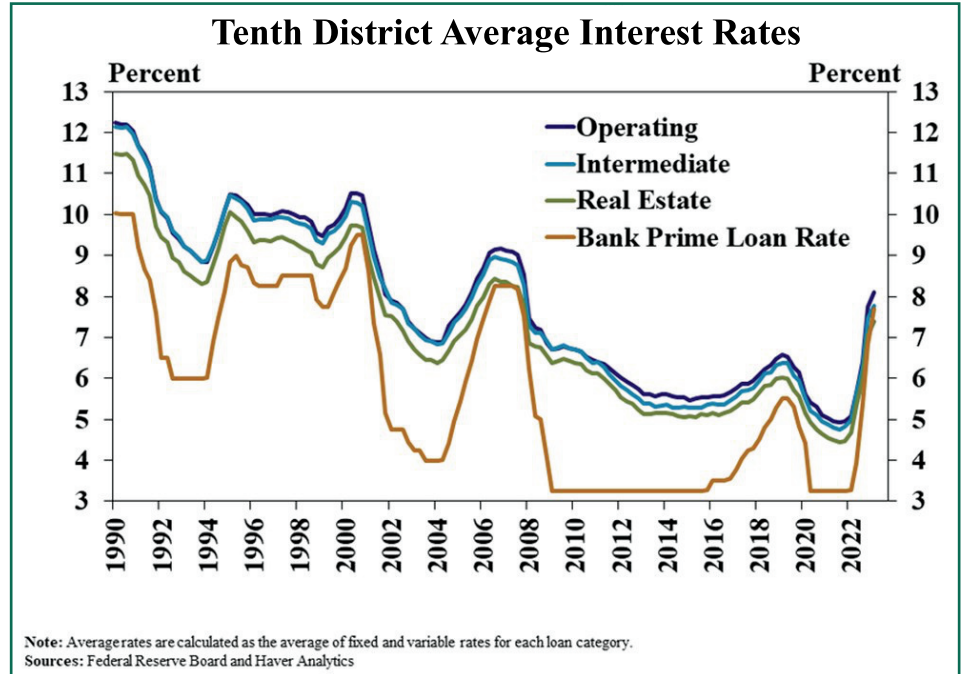
## Farm Interest Rates at Levels Not Seen in 15+ Years

This interest rate chart from the Kansas City Federal Reserve bank shows the average rate charged on all types of farm loans increased for the fifth consecutive quarter and reached the highest level since 2007. Rates on both non-real estate and real estate loans have risen quickly and were nearly 4.5 and 3.5 percentage points higher than the end of 2021, respectively.

Farm loan interest rates rose alongside further increases in benchmark rates. The average rate charged on agricultural loans was about 30 basis points higher than the previous quarter and nearly 300 basis points higher than a year ago. Farm loan interest rates climbed alongside increases in the federal funds rate and other key benchmarks and pushed credit expenses up considerably.

Kansas City Federal Reserve economists Nate Kauffman and Ty Kreitman point out that the growth rate in land values has softened, although the agricultural credit condition remains strong. Farm

income has moderated alongside a pullback in commodity prices. In the quarterly bank survey, some lenders expected a degree of deterioration in the months ahead. However, multiple years of strong incomes continued to keep credit stress low.

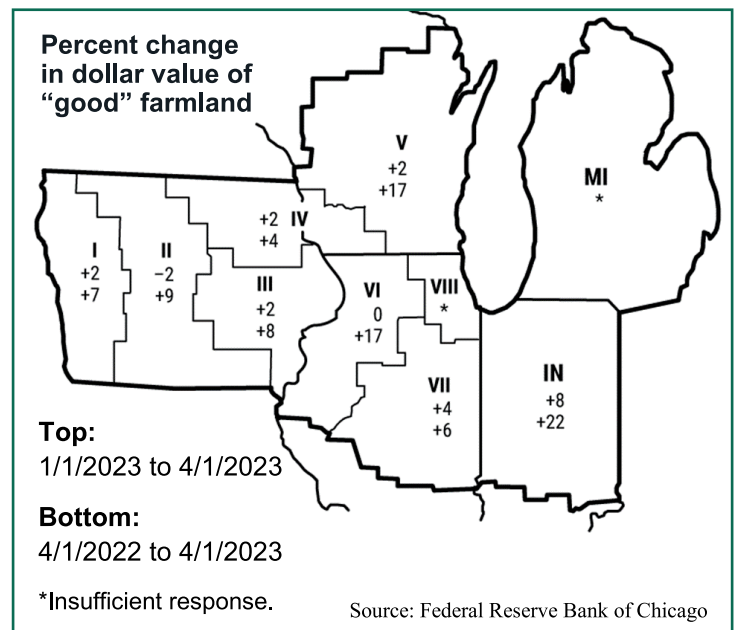


## Farmland Values Stabilizing

Year-over-year farmland values are still strong. In fact, in the Chicago Federal Reserve district, land values posted another double-digit year-over-year gain (10 percent) for the eighth quarter in a row, as of April 1. But the rate of increase is slowing down and a few areas reported no increase, or even a slight decrease, in the average value of good farmland in the first quarter of 2023.

Cash rents in the Chicago Federal Reserve District rose 8% from 2022 to 2023. For 2023, average annual cash rents for farmland were up 10 percent in Illinois, 2 percent in Indiana, 10 percent in Iowa, and 4 percent in Wisconsin. This followed a district-wide 8 percent average increase from 2021-2022. This was the third consecutive annual increase in cash rents following seven years of annual decreases. However, rental rates are a lagging indicator, reflecting the previous year's crop profitability.

Agricultural credit conditions are still in good shape, report the surveyed bankers, despite the jump in interest rates. As of April 1, 2023, the average nominal interest rates on operating loans (7.97 percent), feeder cattle loans (7.93 percent), and agricultural real estate loans (7.14 percent) were



higher than at any time since the third quarter of 2007. Non-real-estate loan demand was down for the 11th straight quarter, reflecting the profitability in farm operations in 2022. Repayment rates for non-real-estate farm loans were higher in the first quarter of 2023 compared with a year ago. And renewals and extensions of loans were lower.

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*continued from page 1*

this spring, but it's worth knowing that the export markets for U.S. grain and oilseeds have been horrible in 2023," notes Hensley. The U.S. corn market has three main uses: generally, roughly 40% goes to livestock feed, approximately 40% is converted into ethanol and the balance 20% is exported. "With Brazil now awash in soybeans and corn, and with importing countries not friendly to the U.S., specifically China, but other countries too, looking for alternative sources, a demand hit in our export business combined with a potential large crop in the U.S. adding to the big Brazilian crops, it's hurt commodities. And, eventually it could pressure farmland values," says Hensley. "Some producers have certainly sold ahead and hedged to lock in some profitable grain sales before this commodity weakness, but even then, in a different commodity environment, it may be hard for buyers to see farmland worth \$15,000 per acre."

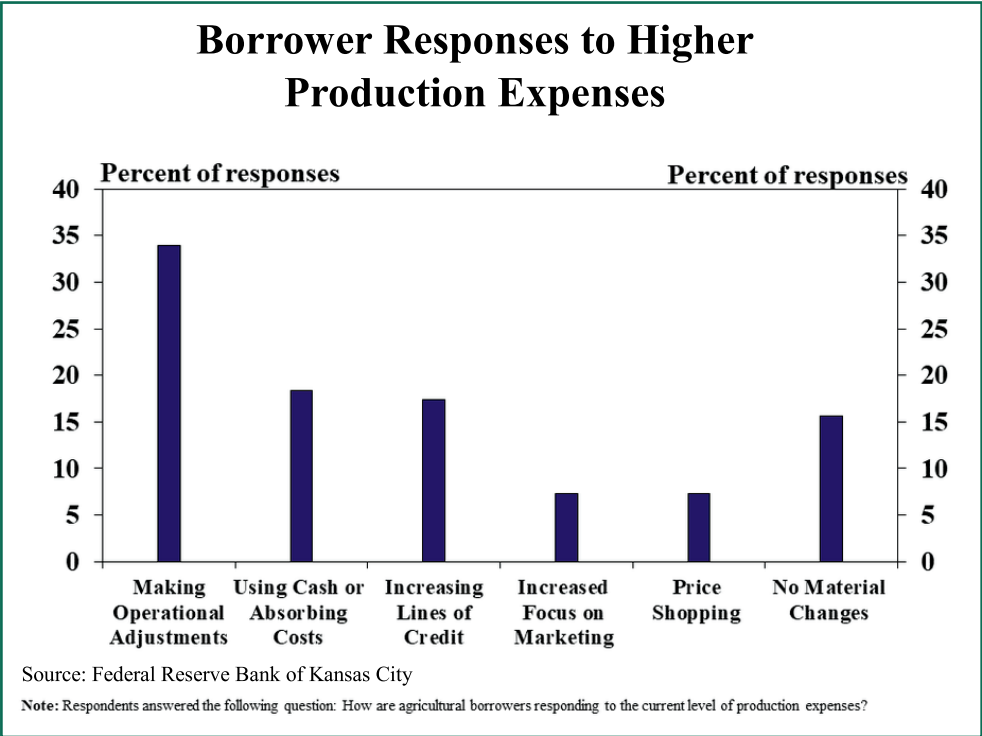
Lower commodity prices could also lead potential farmland buyers to start borrowing money. "Interest rates are nearly double those of a year ago," Hensley says. "And from a cashflow perspective, interest rate levels play into forward thinking, reducing how much a buyer wants to pay for land."

For the better part of a decade, we've had low interest rates. "And many people were lulled into thinking that will continue indefinitely. But now, they've been snapped to attention," explains Hensley. The interest rate environment needs to be factored into the land buying equation, and the last time interest rates were this high was 2007.

Higher interest rates are also slowing down the 1031 tax-deferred land exchanges. "We're still seeing some property developments come on-line. But many, if not most of those, were already in the works," says Hensley. "The developer appetite seems to be slowing down because housing sales have slowed and there is not as strong a demand for new houses with interest rates at these levels," explains Hensley.

Inflation is another component of land investing. "Generally, farmland as an asset class has performed well in an inflationary environment," notes

Hensley. But the most direct impact currently is the Fed's current policy stance of increasing interest rates to combat inflation, which is not supportive to land values. Also, some alternative investments such as money market funds and bank certificates of deposit are now out-performing the 2.5% to 3% annual cash return on farmland investments. So, some potential investors are sitting on the sidelines for now. This could have a small influence on the market, although Hensley does not think it will have an outsize impact, "Because farmers are still the predominant buyer in the land market – 70 to 80% typically – they remain the underlying driver of the land market's direction."



"I do want to emphasize the financial condition of the ag sector is very healthy," says Hensley. "But it's also clear that we are transitioning into a different market than a year-ago. What we are seeing right now is seemingly a plateau in farmland values. And, there's more uncertainty in the market than we've seen since 2020. We're still getting calls from interested farmland buyers, but the land market "feels" a little different and just a touch slower," adds Hensley.

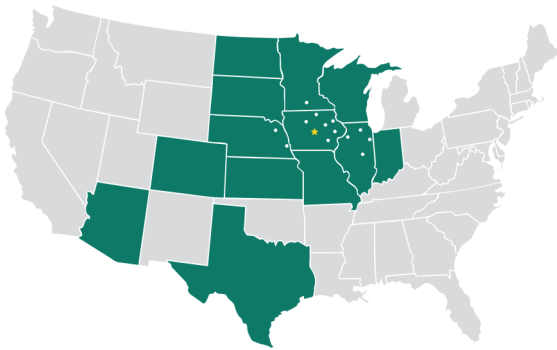
"Out west in the Plains states after years of drought and a devastating winter wheat crop this year, there is some financial weakness. But the belt buckle of the Corn Belt is super financially healthy," Hensley says. "So, we're in a wait-and-see market as we transition from summer into fall."



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## Recent Hertz Sales Continue To Surpass Expectations

### IOWA

**223.55 acres in Marshall Co., IA, south of Conrad** sold via Hybrid auction in early-June for \$19,600/ac. The farm had 218.33 tillable acres with a CSR2 of 91.80. Farm had a history of seed corn production. Sale price was equivalent to \$218.61/CSR2 point/tillable acre. Buyer was a local investor.

**309.44 acres in Buchanan Co., IA, located north and east of Troy Mills** was sold via Hybrid auction in early-March in 3 parcels. Parcel 1 had 154.27 acres with 156.78 tillable acres and a CSR2 of 89.00. Parcel sold for \$17,900/Ac. or \$197.90/CSR2 point/tillable acre. Parcel 2 had 79.00 acres with 76.83 tillable acres and a CSR2 of 87.30, as well as 2.28 acres in a CRP contract. Parcel sold for \$15,200/Ac. or \$179.03/CSR2 point/tillable acre. Parcel 3 had 76.17 acres with 62.29 tillable acres and a CSR2 of 67.70. There were 3.58 acres enrolled in a CRP contract. Parcel sold for \$10,900/Ac. or \$196.88/CSR2 point/tillable acre. All parcels sold to local farmers.

**160.00 acres in Buena Vista Co., IA, north of Truesdale** sold via Virtual Online auction for \$14,800/Ac. in late-March. The farm had 153.50 tillable acres with a CSR2 of 80.80 and included a farmhouse and multiple outbuildings. Sale price was equivalent to \$190.92/CSR2 point/tillable acre. Sold to a local farmer.

**53.85 acres in Story Co., IA, northeast of Zearing** sold via Virtual Online auction for \$15,100/Ac. in early-March. The farm had an estimated 46.77 tillable acres with a CSR2 of 88.00, 3.4 acres in a CRP contract and an open lease for 2023. Farm sold for an equivalent of \$197.57/CSR2 point/tillable acre to a local investor.

### ILLINOIS

**102.83 acres in Grundy Co., IL, west of Mazon** was offered in 3 parcels via Virtual Online auction in mid-March and sold to a single buyer for \$17,800/Ac. or \$130.78/PI point/tillable acre. The farms had a total 97.53 tillable acres with an average CSR2 of 143.50. Property sold to a farmer completing a 1031 Exchange.

**242.75 acres in Tazewell Co., IL, located northeast and southeast of Delavan** were offered in 3 parcels via Hybrid auction in late-March. All three parcels were purchased for \$19,200/Ac. or \$140.66/PI point/tillable acre. Parcel 1 had 80 est. tillable acres with a PI of 141.60; Parcel 2 had 75.59 est. tillable acres with a PI of 139.60; and Parcel 3 had 80 est. tillable acres with a PI of 141.80. Buyers were a local investor and local farmer.

### MINNESOTA

**216.42 acres in Carver Co., MN, southwest of Watertown** were offered in 3 parcels at an In-Person auction in late-April. Parcel 1 had 125.87 acres with 109.23 tillable acres and a CPI of 90.20. It sold for \$10,964/Ac. or \$140.07/CPI point/tillable acre. Parcel 2 had 53.10 acres with 50.26 tillable and a CPI of 87.30. It sold for \$12,241/Ac. or \$148.14/CPI point/tillable acre. Parcel 3 had 37.45 acres with 26.31 tillable and a CPI of 94.30. It sold for \$8,278/Ac. or \$124.95/CPI point/tillable acre. All three parcels sold to local farmers.

**81.2 acres in Watonwan Co., MN southwest of St. James** along Hwy 60 sold via private treaty in mid-April. The farm had 81.18 tillable acres with a CPI of 91.7 and sold for \$11,761/ac. or \$128.29/CPI point/tillable acre to a local farmer.