

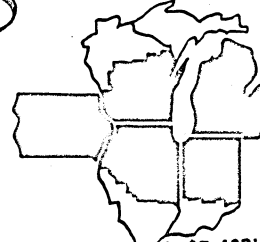
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Agricultural Letter



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Effect of Interest Rates on Real Estate Values
CURRENT SERIAL RECORDS

FARMLAND VALUES in the Seventh Federal Reserve District continued weak during the third quarter. According to an October survey of agricultural banks, the average value of "good" farmland edged slightly lower from both midyear and a year ago. Only in Iowa are land values above year-earlier levels—up 1 percent. Declines in land values continue to be widespread, with 11 of the 17 Seventh District agricultural areas reporting declines from 1969 (see back of Letter).

Bankers expect the current trend in land prices to continue. Nearly three-fourths of the bankers responding to the survey expected land prices to stay at about present levels in the months ahead, while nearly a fifth foresaw declines. These proportions have been gradually increasing with each survey period over the past two years.

The widespread damage from corn blight and drought no doubt tempered the demand for farmland in recent months. The corn crop is down from a year ago in each of the Corn Belt states in the district—ranging from 2 percent in Iowa to 16 percent in Illinois. Demand probably has also been reduced by a general softening in farm income as reflected in cash receipts which ran ahead of a year ago through the first half of 1970 but have since weakened.

The major factor behind the weakness in land values, however, continues to be tight credit conditions. Many potential buyers of farmland have difficulties in obtaining financing at acceptable terms and rates. New farm mortgage credit extended by institutional lenders apparently has picked up slightly in recent months but still is at relatively low levels.

The scarcity of credit and accompanying high interest rates at institutional lenders have caused farmers to turn increasingly to other sources. Individuals, long a dominant source of credit for financing farmland transfers, have become increasingly important. Department of Agriculture estimates in early 1970 indicated individual sellers in the nation were financing around three-fifths of the farmland transfers, compared with less than half in 1969. This proportion was roughly the same for the Corn Belt states but rose to more than three-fourths for the Lake states. Information based on the October survey indicates that the proportion has continued to increase in each of the district states.

Most of the seller-financed credit is extended through instalment land contracts. Downpayments, interest rates, and other terms of land contracts are typically lower or less stringent than those required by commercial lenders, and maturities are relatively short. According to the recent survey of credit conditions in the Seventh District, downpayments were less than 20 percent of the purchase price for more than 70 percent of the transfers financed in this manner. About 70 percent of the reported contracts carried interest rates of under 7 percent; 21 percent carried rates below 6 percent. Nearly 40 percent of the contracts had maturities of ten years or less.

Rate (percent)	Income produced per acre				
	\$20	\$30	\$35	\$40	\$50
	(value per acre)				
6.0	\$333	\$500	\$583	\$667	\$833
6.5	307	461	538	615	769
7.0	286	428	500	571	714
7.5	267	400	466	533	666
8.0	250	375	437	500	625
8.5	235	353	412	470	588

Note: Gross rent per acre in Illinois in 1969 was estimated at \$38.95 per acre—landlord costs at \$15.15 and net rents at \$23.80.

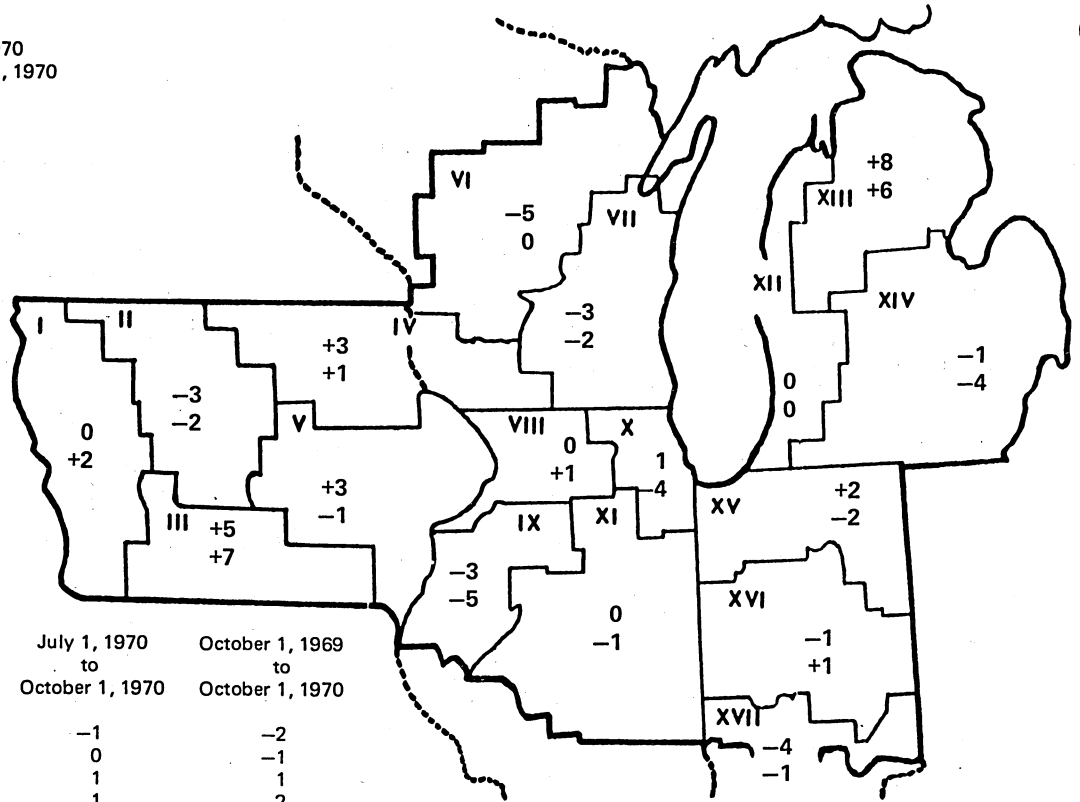
Reported land values in recent years no doubt have been influenced by the lower interest rates and other less stringent terms which are typical of instalment land contracts. The true costs of financing are often incorporated in inflated land prices. Thus, the actual decline in land values almost certainly has been greater than indicated by most surveys. Reports repeatedly indicate that land selling for cash or financed through a conventional mortgage has declined sharply in price during the past two years. Although such effects are impossible to measure accurately, the potential effect of varying interest rates on land values can be illustrated by discounting estimated farm income per acre by different interest rate levels. For example, at 6 percent, land producing \$30 annual net income per acre would be valued around \$500 per acre. At 7.5 percent, the same land would be valued around \$400 per acre.

There may be reason for concern over the relatively large proportion of real estate credit currently being extended through land contracts. In past years, rising land values have resulted in rapid increases in owners' equity. This, along with relatively low interest rates, facilitated the refinancing of land contracts with institutional lenders. If real estate prices were to rise more slowly (or not at all), and credit markets were relatively unfavorable when these relatively short-term contracts mature, refinancing could be difficult.

Roby L. Sloan
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Percent change in dollar value of "good" farms

TOP: July 1, 1970 to October 1, 1970
 BOTTOM: October 1, 1969 to October 1, 1970



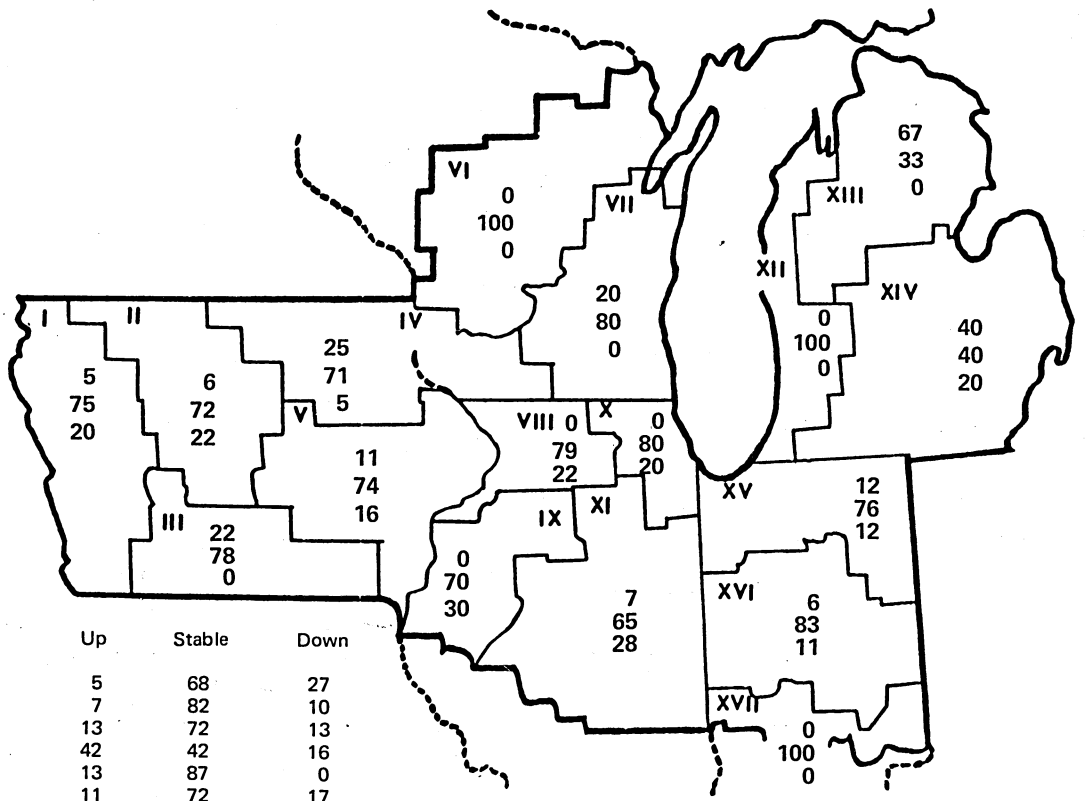
July 1, 1970 to October 1, 1970 October 1, 1969 to October 1, 1970

Illinois	-1	-2
Indiana	0	-1
Iowa	1	1
Michigan	1	-2
Wisconsin	-3	0
SEVENTH DISTRICT	-	-

Current tend in farmland values based on opinions of country banks as reported October 1, 1970

Percent of banks reporting:

TOP: Up
 CENTER: Stable
 BOTTOM: Down



	Up	Stable	Down
Illinois	5	68	27
Indiana	7	82	10
Iowa	13	72	13
Michigan	42	42	16
Wisconsin	13	87	0
SEVENTH DISTRICT	11	72	17

Note: Totals may not add due to rounding