What’s Keeping Illinois Farmland Markets so Strong?

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According to USDA, the average appreciation for farmland in Illinois was 5% in 2003. The Chicago Federal Reserve in its AgLetter survey of agricultural bankers reports a district-wide increase of 7% in the value of good farmland, with upper 2/3 of Illinois experiencing 8% to 13% increases in values. The Illinois Society of Professional Farm Managers and Rural Appraisers (ISPFMRA) conducts an annual state-wide survey, and likewise found strong rates of appreciation, with average appreciation approaching 15% in counties in the “northern corridor” of Illinois and generally strong increases throughout the state.

What factors are contributing most to strong farmland values? While traditional explanations of farmland values focus on farm income as a primary determinant of farmland values, it is increasingly important to account for factors unrelated to the value of farm production.

In a recent study at the University of Illinois, sales data from the Illinois Dept. of Revenue were examined to identify factors associated with differences in farmland prices through time and across locations. Sales from over 64,000 farms covering 4.2 million acres were examined to identify influences of soil productivity, size, location, “ruralness”, population density, non-farm income, distance to cities over 50,000 in population, and livestock production intensity and scale.

Not surprisingly, the results show that soil productivity and land improvements contribute significantly to the farmland value. Further, increasing parcel size has a small negative effect. But these factors do not change much over time, and other sources of income (e.g., government payments) have not increased enough to explain the remaining value increases.

So what other factors help to understand farmland values? Interestingly, distance to large cities is highly significant – even for counties well beyond the northern corridor. Further, the ruralness of a county (measured by USDA “Beale-code”), has a negative impact on farmland values, but not on farm income. Population density has an effect that can be translated as a 10% increase in population increases farmland value by about 7.9%. Non-farm per capital income has a slightly less pronounced effect. Swine production has a more complicated relationship. The study finds that the more swine in a region, the lower valued the farmland, although directional causality is not established. However, more concentrated production (more animals per production unit) is associated with higher values. Thus, for a given total production, land values are highest under concentrated rather than dispersed production systems.
Perhaps even more important is the influence of so-called 1031 or tax-deferred exchanges. In the ISPMRA survey, 45% of purchases were reportedly motivated by 1031 considerations (as high as 60% of buyers in Chicagoland collar counties where over 30,000 new building permits have recently been issued per year). The ability to “trade out” and avoid capital gains taxes translates to higher willingness to pay. In light of the thin market for farmland, the significance of this effect may be difficult to overstate. Relatively low interest rates, and recently high farm incomes further augment the demand by traditional buyers. Finally, the low correlation in farm returns to other financial investments, and attractiveness of real estate as an inflation hedge, also contribute to the continuing strong demand for farmland.