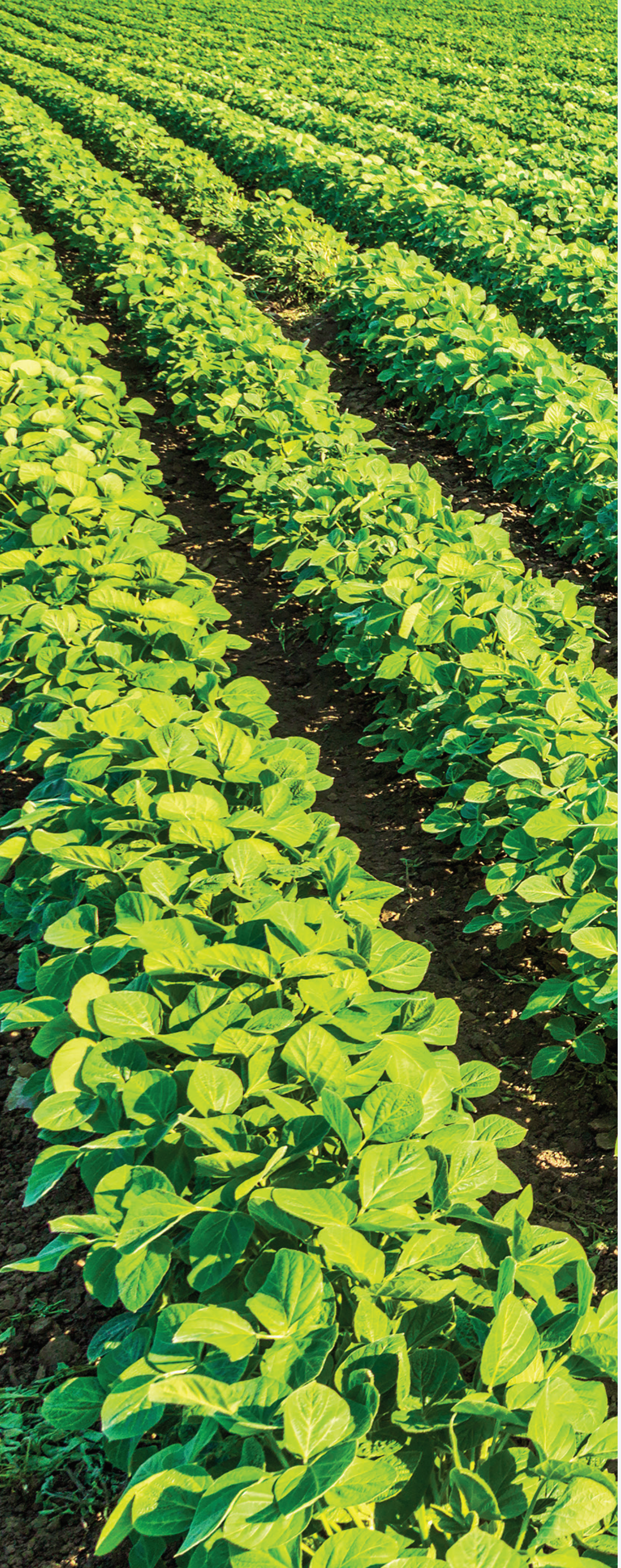

February 7, 2024

Agricultural Finance

2024 Outlook for Annual Crop Farmland Values

Discussion

Guy Haselmann, Head of Thought Leadership at MetLife Investment Management (MIM), recently sat down with Sue Aguilar, Associate Director of Agricultural Finance at MIM, to discuss the state of farm values and credit.

Guy: How have U.S. farm values been affected by increasing interest rates and elevated commodity prices?

Sue: It has been a net positive so far. A steep increase in U.S. farmland values began in late 2021 and accelerated in 2022, reaching a record 12% year-over-year growth, driven mainly by greater demand for high-quality cropland. Despite higher interest rates and some moderation in the farm economy in recent months, strength in farm real estate values persisted in 2023. However, prices in 2023 increased at a slower pace, rising 7.4% year-over-year.

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Guy: What has been the main driver behind the increase in activity and farmland values?

Sue: Momentum in land market value over the past few years has been mainly driven by competition for quality cropland, while at the same time, there is a limited amount of land coming to market. To illustrate, according to industry reports, less than 1% of farmland is available for sale in any given year. The last few years have been quite good for the farmers who have built up strong cash positions due to robust commodity markets and strong cash rents. According to data collected by Farmer's National (a farm real-estate broker that conducts auctions), approximately 80% of cropland transactions occur among farm operators who seek to expand their operations. Institutional investor appetite has been present in the farm real estate market dating back a few decades. However, over the last ten years, there has been a consistent increase in flow of institutional capital into the segment.

Guy: What is the incentive for these institutional investors, in other words, those who are not farmers?

Sue: For institutional investors, adding farmland to their investment portfolios can enhance portfolio diversification and risk-adjusted performance. Most recently, the impact of inflation, steady cash returns, stock market volatility and geopolitical risks have led many investors to seek out alternative investment opportunities that are less correlated to their existing exposures—but have the ability to outperform traditional asset classes. Farmland is a real asset and is typically positively correlated to inflation. For instance, from 2010 through 2022, farmland values, as reported by the USDA, grew 4.7% on average. Comparatively, average inflation during the same period was 2.4%. In essence, using this comparison we can see that for institutional investors, investing in farmland can serve as a capital preservation tool in an investment portfolio.

Guy: Is it possible that these institutional buyers with no ties to the local community can influence land prices?

Sue: Earlier I mentioned that approximately 80% of cropland transactions are between producers. The remaining 20% is comprised of individual and institutional investors, and in this subset, only a fifth of transaction activity is driven by institutional investors. Thus, institutional investor influence is still relatively small.

Guy: What does the future look like for farmland values?

Sue: In the near term, commodity prices will likely continue to be heavily influenced by geopolitical tensions, the rerouting of commodity trade flows and global tight stocks-to-use ratios. Currently, farmland values remain high; however, they're tracking at a slower pace of growth. Going forward, moderation in farm incomes and the highest interest rates in over two decades will weigh on the recent stellar growth we have seen in farmland values. It is important to note, however, that a growing population will always mean a growing need for food, shelter, and clothing—all of which require land.

Guy: The December FOMC minutes stated that rates were "likely at or near their peak for this tightening cycle" and their Summary of Economic Projections forecasts three rate cuts in 2024. If rates are cut due to a recession, is that good or bad for farmland prices?

Sue: As your question implies, preliminary projections suggest that official interest rates have peaked or are close to peaking. The MIM house view holds that the most likely outcome will be that the U.S. will enter a mild recession in 2024 and that the Fed will begin a rate cut cycle around mid-2024. A reduction in interest rates will support farmland prices and profitability. Whereas a continuous increase in interest rates represents a considerable headwind to farmland markets. A rising interest rate environment drives interest expense higher, which in turn limits producers' liquidity.

Guy: How have borrowing costs affected farmland loan demand and farm real estate values?

Sue: Loan demand has been soft because farmers have ample liquidity due to consecutive years of high farm incomes. Additionally, the average fixed interest rate on farm loans rose to about 8% in the second half of 2023. This is the highest rate in over 20 years. Currently, farmers don't really need as much debt, and debt is more expensive, so lending volumes are down.

The impact on values has been less direct. As financing has become more expensive, it is muting upward pressure on land values. As I mentioned before, in 2022, land values grew 12% year-over-year on average, while in 2023 values grew 7% year-over-year. Most of this slowing is related to the moderation in commodity prices and higher interest rates.

Guy: What is MIM's view about current farmer sentiment and the ag economy?

Sue: Farmers always deal with quite a bit of uncertainty, but today they are generally optimistic. They are less concerned about interest rates; they have high farm incomes; and working capital remains healthy. Although commodity prices have eased, input costs throughout 2023 have significantly decreased from 2022 record highs. This has helped keep farm economics on solid footing. For 2024, we must remember that commodity prices go through cycles, and prices have the tendency to trend back toward the commodity's cost of production. At current USDA cost of production projections, corn and soybean prices are set to decline closer to their respective cost of production levels. Likely, we can expect farmland values to plateau in 2024 or at best, achieve a slower rate of growth, year-over-year, of under 5%.

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