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DEPARTMENT OF AGRICULTURAL ECONOMICS

THE LAND PRICE SITUATION WITH SPECIAL REFERENCE TO TRENDS AND THEIR CAUSES, 1912-1947[1 2]

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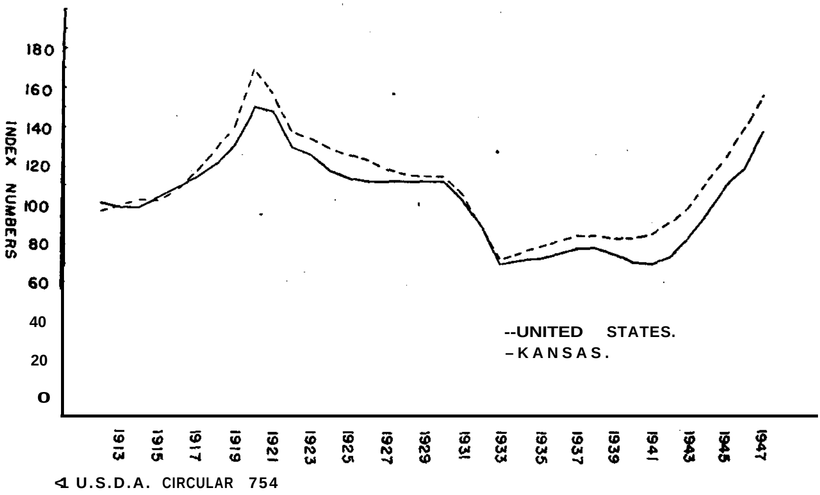

Fig. 1.--Farm Real Estate Price Trends per Acre, 1912 to 1947. (1912-14=100).

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INTRODUCTION

Land prices have fluctuated widely throughout the past 35 years. Sharp fluctuations have tended to create uncertainty concerning the true value of real estate. The purposes of this report are two-fold: (1) To portray concisely the historical background of the current situation; and (2) to reveal current trends in relation to causes of trends and the potential problems pertaining thereto.

Developments in real estate prices have much significance. Individual landowners, business firms, credit agencies, and public officials who have responsibility for determining reasonable assessed valuation, have an interest in levels and trends in land prices. The level attained by land prices will distinctly influence the annual cost of an investment in land. As the principal of the investment advances, the gross interest cost increases. When land prices move upward assessed valuation tends to follow.

Land is a basic source of wealth. Fluctuations in land prices, therefore, are a matter of special concern. Reasonable stability in land prices is essential to stability in agriculture. No more than a brief look at economic problems elsewhere in the world reveals the relation between this important basic resource and economic stability generally.

BACKGROUND OF THE PRESENT SITUATION

A brief review of land price trends since 1912 may be helpful. The successive stages in the national and Kansas averages are clearly portrayed in Figure 1. The national averages by years are revealed in the upper trend line, and those for Kansas are represented by the lower line. In both cases, averages are computed in terms of index numbers with 1912-14 as a base period.

The base period, 1912-14, provides a useful foundation for a portrayal of long-run trend. Questions are raised frequently concerning the level of land prices in the 1935-39 period in relation to 1912-14. Even more frequently, questions arise concerning the comparability of the effects of the two world wars upon land prices. Answers to these questions are available through study of the basic data from which the trend lines in Figure 1 were constructed.

It is obvious that both world wars provided strong stimuli to land prices. In the case of World War I the most rapid advances in land prices occurred in 1919. The peak in prices came in 1920. Then declines set in and recessions in both the national and Kansas averages took place at a relatively rapid rate until approximately 1927. Thereafter, a leveling off occurred, with land prices holding steady until 1930. During the next three years, 1930-33, another sharp recession developed. As a consequence, by 1933 land prices had declined to a point lower than at any other time in the 35-year period. Between 1933 and 1941 no definite or consistent directional movement was apparent. Then came World War II. Since the beginning of World War II the trend in land prices has been clear and unmistakable.

There are significant aspects in the history of land price movements during the past 35 years which appear worthy of special mention. Using 1912-14 as a base period represented by an index of 100, the 35-year national average index is 111. At the high point in 1920 the index was 170, or 59 points above the 35-year average. The low point in 1933 is represented by an index of 73, a level 38 points below average. In the 35-year period the 1916 and 1944 index numbers are the most nearly average. The 1946 national average index number is 146, or 35 points above the long-run average. Since then, the trend in land prices has continued upward. During the first quarter of 1947, an index of 159 was attained.

The historical background of the Kansas situation is comparable to that of the nation. The long-run (35-year) average in Kansas is represented by an index of 103. As in the national situation, so also in Kansas the high point occurred in 1920 and the low in 1933. In 1920 a high of 151 was attained, 48 points above the long-run average. In 1933 a low of 70 revealed the extent of the decline at its lowest point. From 1942 to the present time advances have been continuous and distinct. At the close of the first quarter of 1947 the index was 140, revealing a level approximately 37 points above the long-run average.

THE PRESENT SITUATION

The stimulating effect of World War II has caused land prices to move upward sharply. Just as a stimulant may over-energize the human body, so do wars distinctly stimulate the economy of a nation. Major wars are particularly severe.

Since early in 1942 land prices have advanced on the average approximately 1 percent per month. Advances have not been uniform, either by regions or by periods of time. Throughout the United States as a whole land prices are now approximately 75 percent above those of March 1942. As a consequence of the advances since 1942, land prices range above 1919 levels in 39 states and above the levels of 1920 in 24 states.

As has been noted previously, the index of land prices in Kansas is approximately 37 points above the average of 1912-14. This overall increase in land prices is worthy of attention, but it may be more worthwhile to consider the trend in land prices by type-of-farming areas within Kansas.

Figure 2 reveals the trend since 1940 in land prices by type-of-farming areas. Prices have moved substantially higher in the wheat areas of the southwest and south central parts of the State. Increases have been more moderate in east and north central Kansas. This situation is the opposite of the trend which followed World War I. At that time the more sensational increases in price occurred in northeast and north central Kansas.

Figure 2 (a) portrays the approximate average levels of land prices in type-of-farming areas for the years 1919 to 1925 inclusive. The differences in the levels attained by land prices throughout the state are apparent. No particular significance should be assigned to the differences in the trends portrayed by Figures 2 and 2(a), for the two periods are not completely comparable.

Figure 3 reveals five-year land price averages in those areas of the state in which the most recent five-year average (1943-47) is’ higher than that of the first period (1923-27) for which data are available. An enclosure of these areas on a map of Kansas shows that they comprise a contiguous area in which a major portion of the wheat crop of the state is produced.

There are many reasons for the variations in land prices by type-of-farming areas within Kansas. Some of the underlying reasons are more important than others.

It has been pointed out that the largest increase in land prices has taken place in the western, particularly in the southwestern, counties of the state. The substantial increase in the net returns to farmers of that area is perhaps the single most important factor.[3] Figures 4 to 7 portray the trends in land prices by type-of-farming areas, in relation to (1) net income per acre by years, and (2) longtime average income per acre. Figure 4 for Area 8 (north central Kansas) is typical not only for that area but to a certain extent for eastern Kansas areas. In recent years the aver-

[3] Data on net income per acre were obtained from records on Farm Management Association farms.

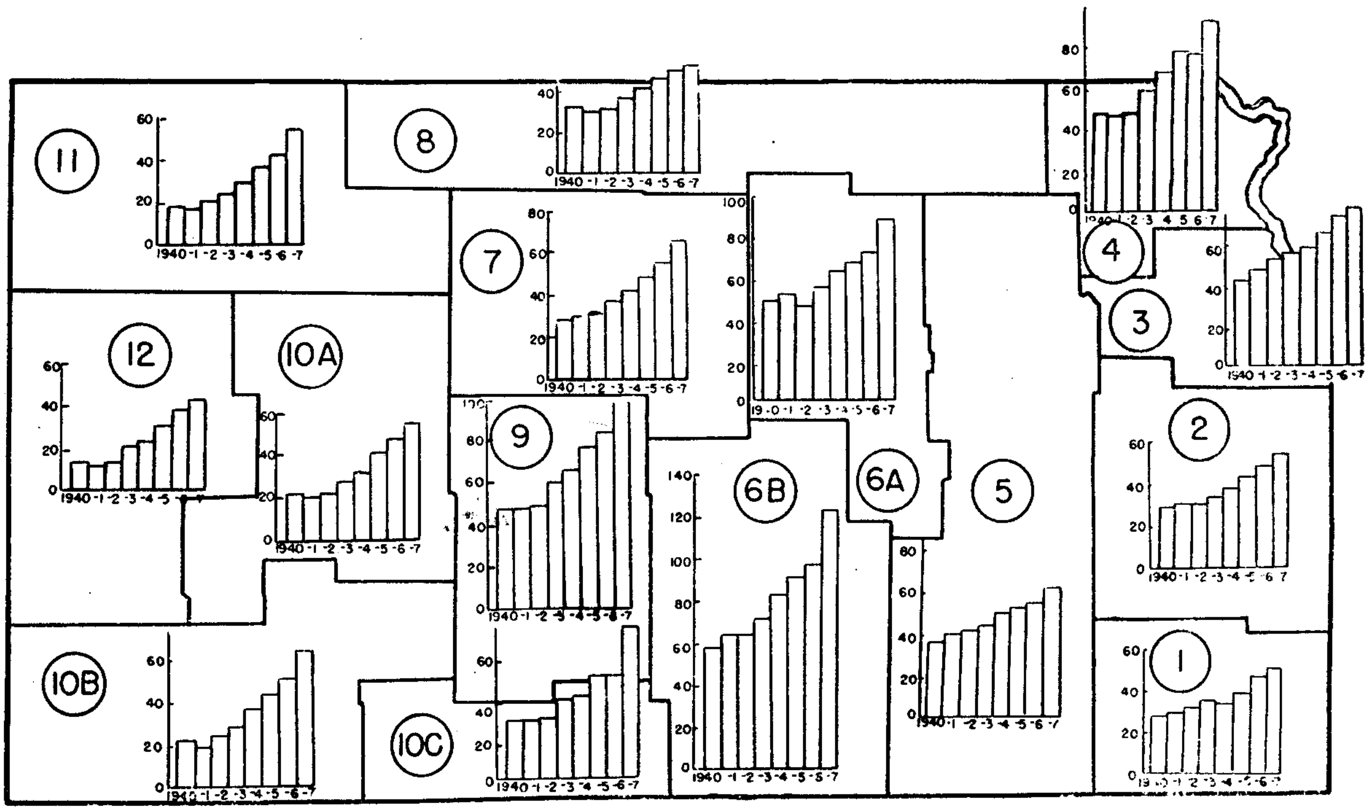

Fig. 2.—Land Price Trends in Kansas by Type-of-Farming Areas, 1940 to 1947. Source of data: March 1 schedule of the Federal-State Crop Reporting Service.

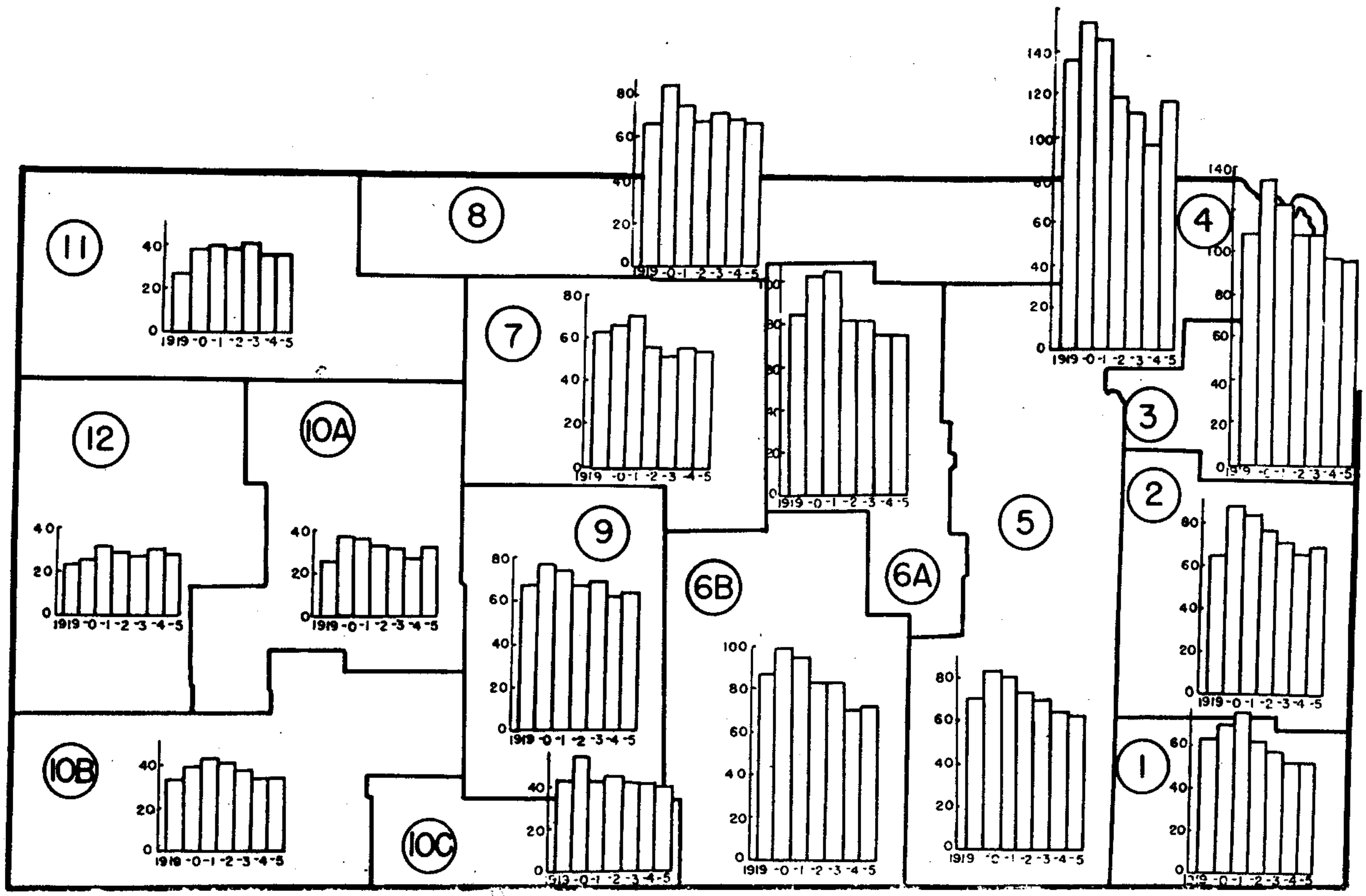

Fig. 2 (a).—Land Price Trends in Kansas by Type-of-Farming Areas, 1919 to 1925. Source of data: March 1 schedule of the Federal-State Crop Reporting Service.

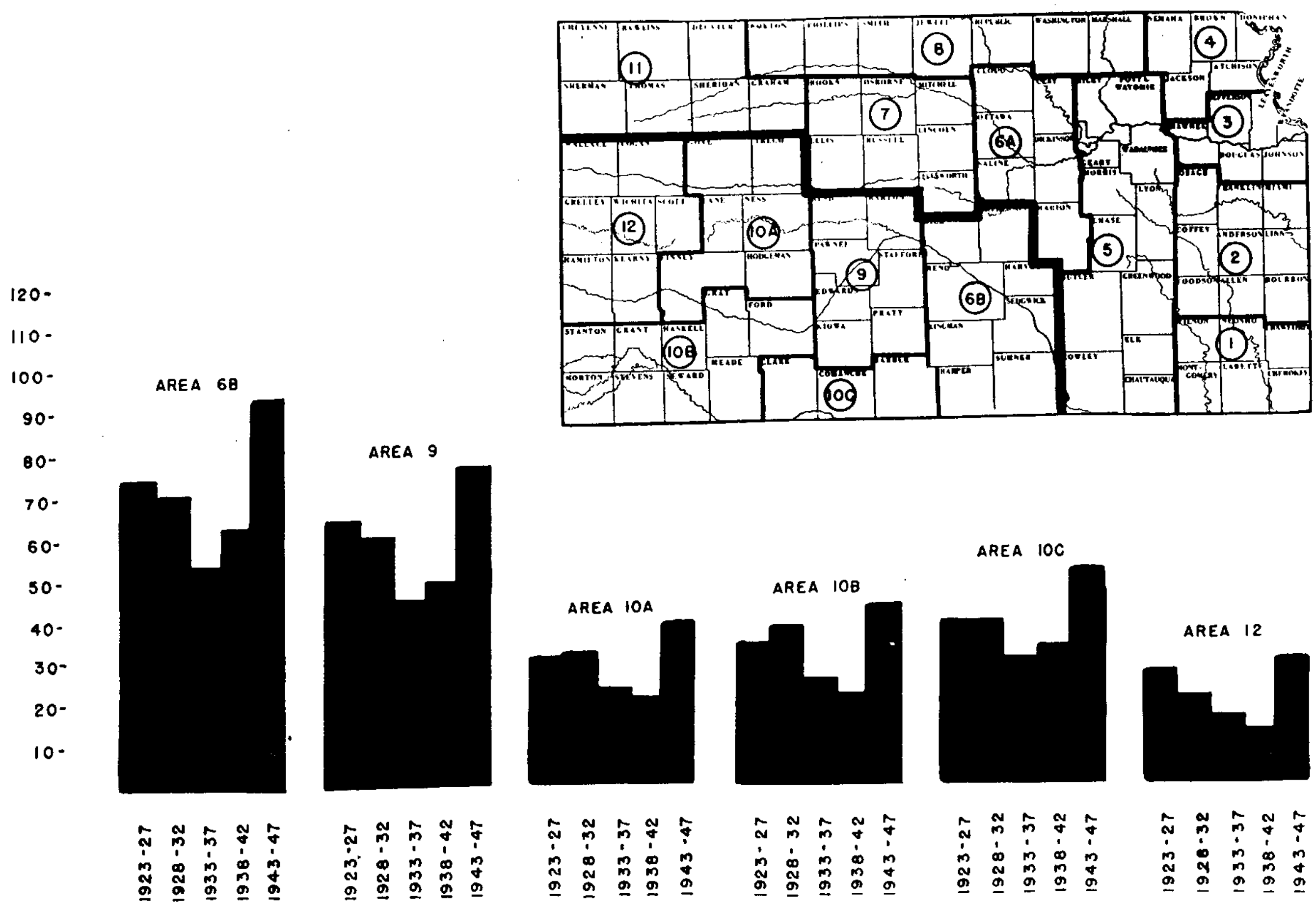

Fig. 3.—Average Price of Land by Five-Year Periods for Selected Type-of-Farming Areas in Kansas.

age income per acre has risen distinctly above the long-run average level of income. One of the more significant observations is that the price of land has tended, recently, to pull away from the long-run level of average income per acre. This development provides the occasion for a sense of concern among persons who have placed their trust in agricultural stability.

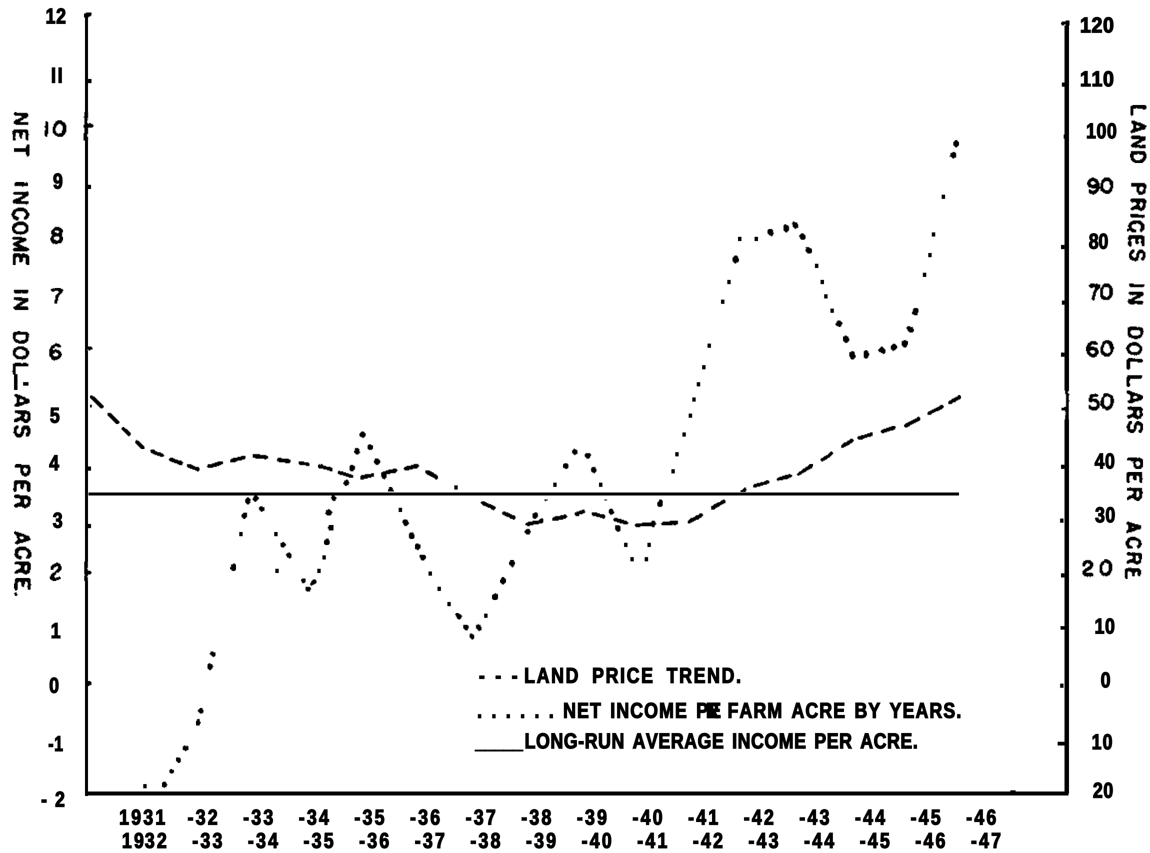

Fig. 4.--Land Price Trends in Relation to Net Income per Acre--Type-of-Farming Area 8, 1931 to 1947.

In Area 5 (Fig. 5) net income from land and land prices has remained somewhat more stable than in other areas. That greater stability appears to be due largely to the fact that this is a grass and livestock production area.

Improved farming practices have increased materially the efficiency of farmers in all areas of the state. This factor may have had an especially noticeable influence on the situation in certain areas, particularly in western Kansas. Improved practices make farmers better able to cope with the problems of any area. A more stable production situation results in added long-run value for land.

The mortgage foreclosure experience of the 1920's and early 1930's was firmly impressed upon the minds of many landowners and credit sources in eastern Kansas. In view of the fact that land prices advanced less distinctly in western Kansas after World War I, there was less of foreclosure and other similar

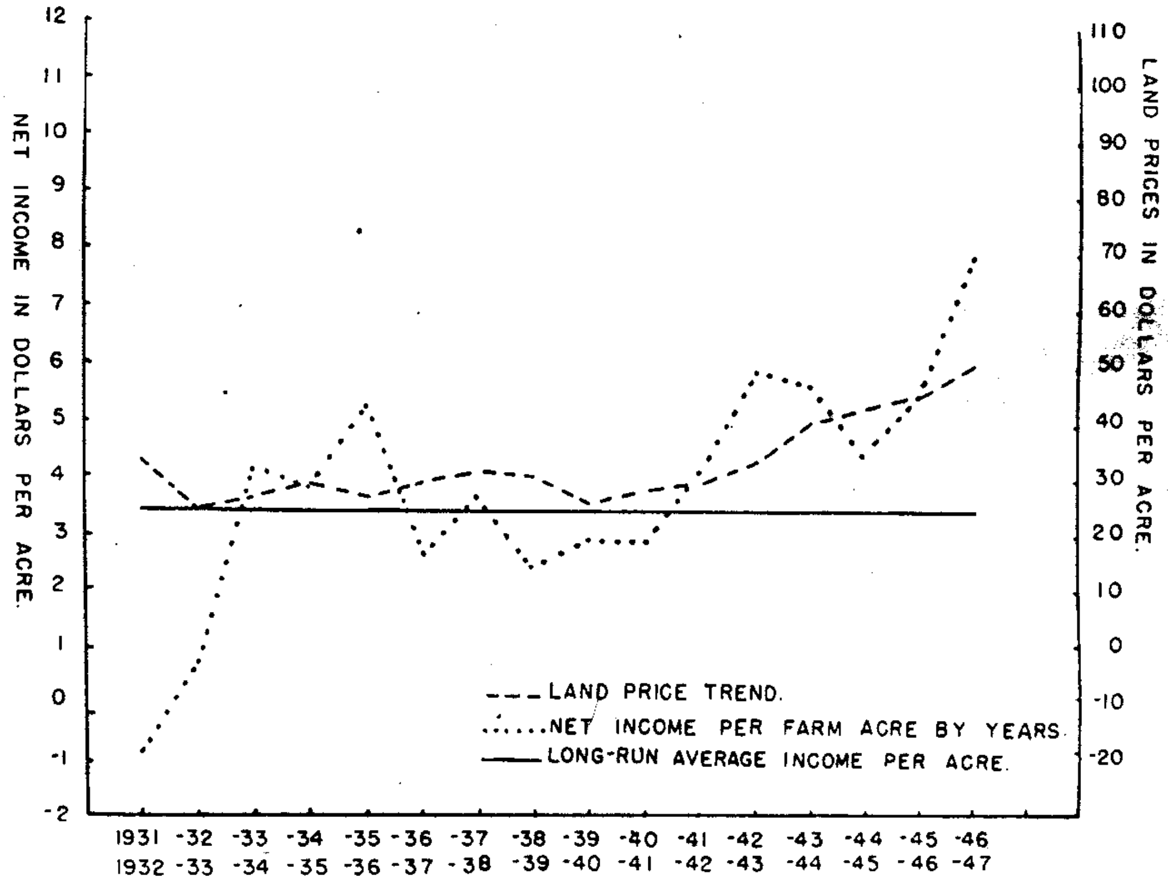

Fig. 5.—Land Price Trends in Relation to Net Income per Acre—Type-of-Farming Area 5, 1931 to 1947.

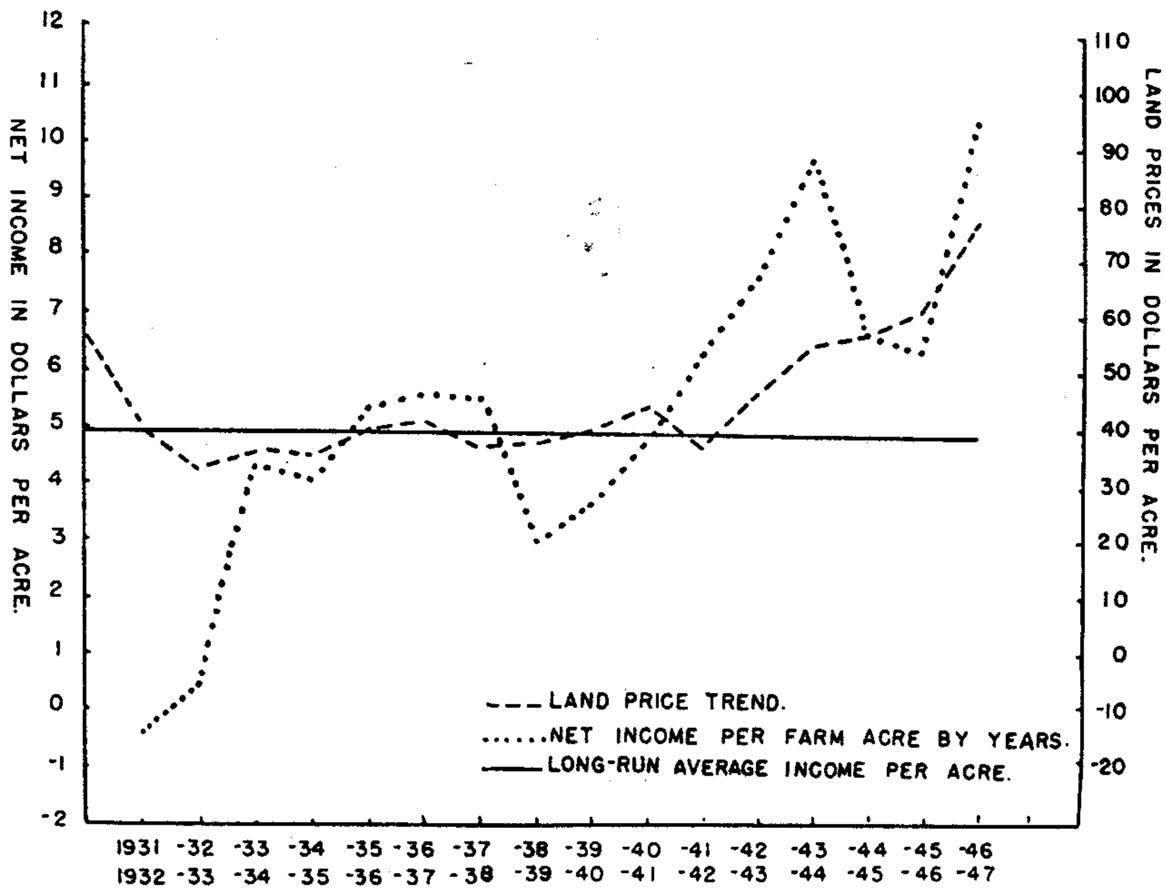

Fig. 6.—Land Price Trends in Relation to Net Income per Acre—Type-of-Farming Area 6a, 1931 to 1947.

grief in that part of the state. In contrast, much of the difficulty in western Kansas was caused by adverse weather conditions rather than by inflated land prices. Improved weather conditions in recent years may have tended to cause some farmers, particularly the younger farmers, to forget those adverse conditions.

In Area 6a (Fig. 6) the levels of land prices and average in-

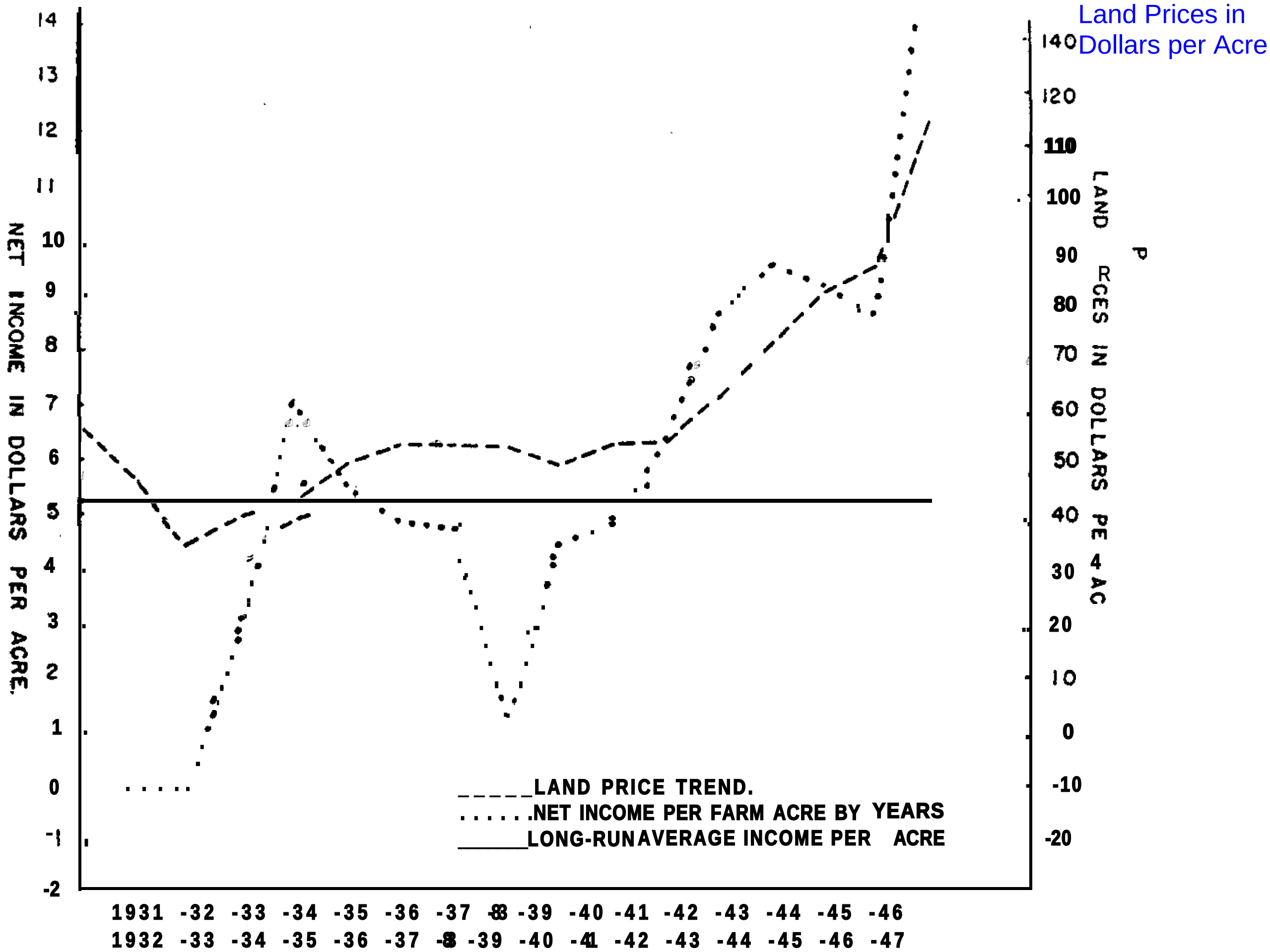

Fig. 7.—Land Price Trends in Relation to Net Income per Acre—Type-of-Farming Area 6b, 1931 to 1947.

come per acre are following more nearly the same trend, but also have tended to pull away from the long-time average income. This same observation may be made in Area 6b (Fig. 7). The rise of both income and land prices has been sensational in this area, and it would seem that the gap between the long-run average income and the land price level may be too wide.

In the case of Areas 8 and 5 factors other than income, some of which have been discussed previously, may be having a greater influence on land prices than has been exerted by income. In Area 6b, especially, income appears to be the major factor, which is somewhat typical of much of central and southwestern Kansas. In addition to the influence of farm income, there is a potential income factor which has its foundation in the development of natural resources, such as oil and gas, in central and western Kansas.

Another factor which influences land prices is the interest rate charged for the use of borrowed money. In 1910 the average rate of interest charged by all lenders on real estate mortgages was 6 percent. That average rate increased until 1923, when it reached 6.4 percent; after that time it declined steadily until 1945, at which time the average rate for all lenders was 4.5 percent. Since 1945 the trend has been upward slightly to 4.8 in 1946. This upward trend in interest rates may continue slowly as long as prices are high and as long as there is a sufficient demand for credit. However, the large amount of money in circulation and the management of a large public debt likely will tend to hold interest rates below those of the period immediately following World War I.

Another influence in the upward movement of interest rates is the tendency in prosperous times for real estate mortgages to be written on the basis of a shorter repayment period than in times of lower average incomes. This tendency is reflected in the larger percent of real estate loans currently made by short term lenders, such as individuals and commercial banks. Short term loans generally command a higher interest rate. The percent of farm real estate loans made by individuals and commercial banks increased from 62 percent of the total transfers involving mortgages in 1943 to 73 percent in 1946.

Low interest rates generally are considered beneficial because of the reduced cost to the borrower. However, it seems probable that low interest rates have been capitalized into higher land prices in the recent past. Obviously that is not desirable. The effect of this tendency can be illustrated as follows: A five-dollar-per-acre net income capitalized at 6.4 percent indicates a probable valuation of $78.12 per acre. On the other hand, a five-dollar net income capitalized at 4.5 percent suggests a valuation of $111.10, a figure 42 percent larger than the valuation at the 6.4 percent rate.

Another factor in the capitalization of low interest rates into land prices is higher net incomes. The current level of income in some areas is a temporary situation. A good illustration is net income of near $15 per acre in 1946 on land in Area 6b compared with the long-run average income of near $5 per acre. The sensational increase in land prices in that area is partially due to capitalization of short-run net incomes at abnormally low interest rates. This trend may be influenced to a certain extent by the fact that idle funds in many cases are in the hands of farmers who have almost unlimited confidence in land as an investment and who give little consideration to alternative uses for their idle funds. This situation will be relieved to some extent when more goods become available on the market.

The trend in the average term for which farm real estate mortgages are written has been the reverse of that of interest rates. For the period 1917-21 the average length of farm real estate mortgages in the United States in the case of loans made by individuals was 3.7 years. This period declined to an average of 2.9 years during the depression period 1932-35, but by March of 1945 the average had increased to 4.5 years. This trend was typical of other short term lenders. Commercial banks had adopted the same policy. Terms of mortgages written by life insurance companies increased from 7.5 years in the period 1917-21 to 15 years in March 1945. Length of term in the case of mortgages written for Federal Land Bank and land bank commissioner loans decreased from an average of 30.9 years for 1917-21 to 22.9 in March 1945. The introduction of the shorter term land bank commissioner loans during the depression years was in part responsible for this decrease.

Recent trends in land prices and related factors can only be judged in light of past experiences. It is unlikely that history will repeat itself precisely. Some recession in land prices is likely in certain areas where advances have carried prices beyond a level justified by long-run conditions. However, it appears unlikely that there will be a restoration of prewar (1935-39) price levels in the foreseeable future.

At present more than 50 percent of the land transfers are entirely for cash. This compares with an estimated 10 to 20 percent of the transfers made entirely on a cash basis following World War I. A less favorable factor, currently, is that in three-fourths of the transfers involving a mortgage the purchaser's equity in the farm is less than 50 percent of the purchase price and in 25 percent of the cases the equity is not to exceed 25 percent of the purchase price. This may be even more serious when one considers that on the average farm in the United States, in the first quarter of 1947, a mortgage equal to 52 percent of the purchase price would have been equal to its full value in 1941.

Another favorable factor in the farm mortgage situation is the relatively low level of **total** mortgage indebtedness of farmers at the present time. In the United States on January 1, 1946, the total indebtedness of $4,730,000,000 on farm real estate was the lowest since 1915 and contrasted with a peak of $10,785,621,000 in 1923. In Kansas the mortgage indebtedness of $144,278,000 in 1946 was lower than in 1915 and compared with $527,397,000 in 1923. Recent information indicates that the trend in farm real estate indebtedness has started up again. During the year 1946 this increase in the United States was reported to have been $160,000,000. A corresponding figure is not available for Kansas. The amount of increase in indebtedness is not large compared with the total indebtedness. However, the change in the direction of the trend is significant. In addition to the low indebtedness of farmers there is an all-time high in liquid assets, including cash, government bonds, and other investments at the disposal of farmers currently. These are favorable factors, providing they are not allowed to push real estate prices up to levels that cannot be supported by long-run average conditions.

SUMMARY AND CONCLUSIONS

Land prices have advanced sharply as a consequence of the influence of World War II. The prevailing situation in Kansas differs in some important respects from that which existed at the close of World War I. The more distinct advances in land prices have not occurred in the same areas in both periods. The financial position of agriculture is stronger now than at the close of World War I.

There are also some similarities in developments which followed both world wars. Wartime increases in income greatly stimulated land prices. Optimism concerning the likelihood of an indefinite continuation of favorable commodity prices has prevailed in both periods. Average or better than average crops and exceedingly favorable commodity prices have occurred simultaneously in both cases.

There is a well founded assumption that agriculture is confronted currently by a situation which involves (1) the continued need for large foreign markets, and (2) a sufficiently enlarged domestic market to provide outlets for increased productive capacity. If the markets for agricultural products continue strong, such strength will give support to land prices. On the other hand, if appreciable weakness develops in markets, or if drought recurs for two or more successive years, downward pressures will be exerted on land prices, as was the case after World War I.