Farmland
# SEASONS
Winter 2010



# What Next for the Economy?

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## In this Issue:

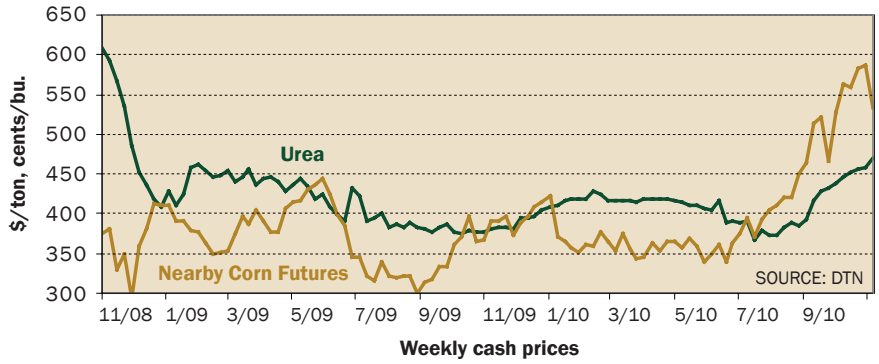
# Production Costs Are on the Rise for 2011

Cost of production will be up in 2011, led by rising fertilizer prices. Bruce Erickson, Purdue University director of cropping systems management, estimates corn variable expenses not related to land or labor up 13% to 14% and soybeans up 6%.

For average cropland, he projects costs at $404/acre for continuous corn, $387 for rotational corn and $194 for rotational soybeans.

For high productivity Illinois farmland, Gary Schnitkey, agricultural economist at the University of Illinois, projects costs before land or return to management at $482 for corn and $294 for soybeans, compared with $441 and $278 respectively in 2010.

### Corn and Fertilizer Tend to Move in Same Direction




Whereas spring prices were in the low $500 range for ammonia, diammonium phosphate and potash, those prices rose to $736, $661 and $526, respectively, in late November, Erickson notes.

Although fall application went well, fertilizer demand will remain strong: Acreage of corn, soybeans, wheat and cotton, which typically account for 70% of U.S. fertilizer use, could be up 6 to 8 million acres next year, some estimate.

"If 2011 December corn is more than $5/bu. in the spring, I would not expect NH3 prices to decline from the prices we've seen this fall," says Steven Johnson, agricultural economist at Iowa State University.

Johnson and others urge producers to lock in profits by pricing some corn at the same time they pay for seed and fertilizer. "Crop prices and yields are higher than five years ago, but the net profit margin per acre may not have changed significantly," he says. "Farmers are simply handling more dollars."

# The World Numbers Game

*In each issue of Seasons, we'll supply comparative numbers that affect farmland prices or investment. The answer to what these numbers represent appears on the next page.*

SOURCE: WORLD DEVELOPMENT INDICATORS; WORLD RESOURCES INSTITUTE

| | Total (mmt) | Per hectare (kg) |
|---|---|---|
| Argentina | .74 | 30.3 |
| Australia | 2.3 | 46 |
| Belgium | .29 | NA |
| Brazil | 7.7 | 114 |
| Canada | 2.6 | 54 |
| China | 39.6 | 256 |
| France | 4.0 | 212 |
| Germany | 2.6 | 228 |
| India | 16.1 | 99 |
| Indonesia | 3.0 | 74 |
| Italy | 1.4 | 159 |
| Italy | 1.4 | 159 |
| Malaysia | 1.2 | 188 |
| Sweden | .27 | 104 |
| USA | 19.3 | 103 |
| Venezuela | .30 | 74 |

## Land is Fairly Priced

In the next year, farmland returns are likely to increase because of above-average commodity prices, and higher interest rates do not appear likely within the next year or two as the Federal Reserve seems intent on an easy monetary policy. Both these factors support land prices, according to University of Illinois economist Gary Schnitkey.

One indicator of whether land prices will rise or fall is a comparison of farmland and cash rental rates, Schnitkey says. They are in alignment right now.

Dividing cash rent by the interest rate determines "capitalized value"—the estimated discounted value of future cash flows to farmland. Then dividing land price by capitalized value derives the price-to-value ratio.

"In 2010, using Illinois average land values and cash rents, the price-to-value ratio is 95%," he says. "So land price is about right for the returns, and at this time, it doesn't seem likely we will see any downward pressure on farmland prices."

## *Land Market Update:*
# Food Security Drives Land

*By Josh Waddell, Vice President*

As 2010 draws to a close, one of the most notable changes in the agricultural land market is the attention it is drawing from new investors worldwide. Ranging from hedge funds that are developing unused land in Zambia and Mozambique to foreign governments seeking to pour billions of dollars into row-crop production worldwide, the rush to secure a steady supply of food is driving land markets around the globe. While much attention is being paid to the developing world, with its higher returns in exchange for more risk, the U.S. still stands out as the world's safest place to invest in production agriculture.

I recently attended the Global Ag Investing 2010 Conference in Geneva, Switzerland. In attendance were some of the largest and most active fund managers and land investors from around the world. A paramount focus of this conference was to explore agricultural land as an emerging asset class and determine, as well as possible, the outlook for this asset class over the next few years.

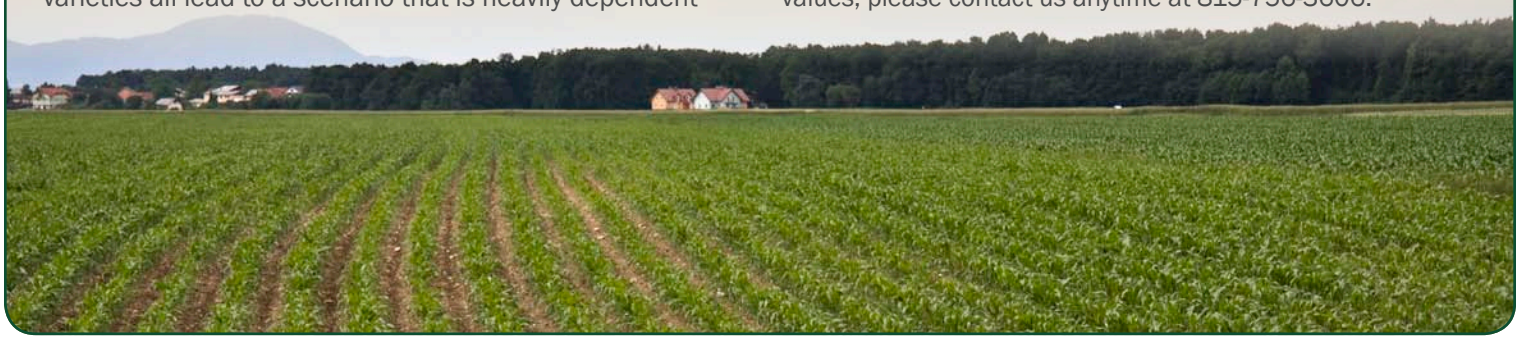
We also heard very informative discussions regarding the various challenges that lay ahead for feeding a growing world. Population growth in Asia, water scarcity, and the general leveling off of technological strides in seed varieties all lead to a scenario that is heavily dependent on U.S. agricultural output to feed the world. If you couple historically high grain prices with the new attention being paid by institutional investors and foreign governments, it is not difficult to see why the land market in the Midwest is as strong as it has been in recent memory.

Sales in the Corn Belt have been brisk in 2010, leading to a relatively modest inventory of productive cropland listings. We have sold more raw land this year—approximately 60 parcels totaling nearly 15,000 acres—than any year since our company's founding in 1975.

The "type" of buyer for Midwest farmland continues to be predominantly local farmers and regional investors, but new institutional investors are entering the market in earnest. We continue to assist banks and developers with liquidating development land in the Chicago area. Much of the land formerly slated for various types of real estate development is being acquired by a new crop of farmers and investors for a slight premium over agricultural values.

Our farm management department has been instrumental in assisting new investors in building up and maintaining fertility levels and finding qualified operators to provide an optimal level of return. Given that the highest and best use for many of these properties will be agricultural production for the foreseeable future, it is vital to maintain fertility levels and safeguard the productivity of this land in the coming years.

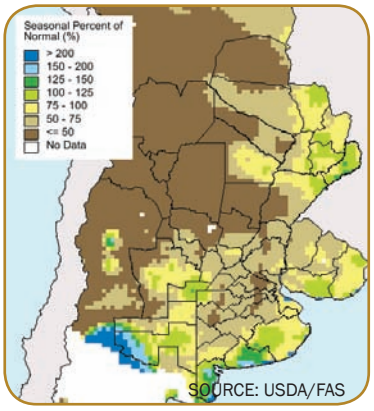
If you have any questions or would like to discuss land values, please contact us anytime at 815-756-3606.



# World Weather "Hot Spot"

La Niña is on center stage. This cold ocean water event is expected to last at least into the Northern Hemisphere spring; some forecast it could remain until 2012. "Current indications are that this event will be one of the strongest La Niñas ever recorded," says Allen Motew, meteorologist for QT Weather.

"La Niña typically is associated with late-arriving seasonal rainfall and then erratic rains in the initial weeks of the rainy season in South America," reports Drew Lerner of World Weather Inc. "This year is no different; less-than-usual rainfall is occuring in Argentina, Uruguay and southern Brazil. Of most concern in mid-November are Argentina and Mato Grosso do Sul." Traders are tuned in to every weather report coming out of the area and its possible effects on potential production.




Answer for World Numbers Game: Fertilizer use

# Can the Fed Heat Up the Ec

*Quantitative easing is the Fed's latest effort to boost growth*

When the U.S. Federal Reserve announced in November that it will buy $600 billion of U.S. Treasuries through June on top of an earlier round of similar purchases, it set off a volley of op-ed articles and stirred up markets. The goals of the record stimulus move are to reduce unemployment and economic stagnation.

The economic malaise that started with the subprime mortgage implosion in the summer of 2007 is more virulent than past episodes, according to a study by Carmen Reinhart of the University of Maryland. Financial institutions slashed new lending, and some markets were seriously impaired. In addition, declines in GDP spanned at least 90 countries.

The Fed's first line of defense against a slow economy is to lower interest rates, making it easier for businesses and consumers to borrow and buy. With the Fed lending rate now at zero, it has no further arrows available in that quiver.

## QE Impact on Economy:

**A $500-billion Treasury purchase = 0.5 to 0.75 cut in Fed Funds Rate**

*—William Dudley, NY Fed*

Yet banks are not lending; consumers are paying down debt, not taking on more; businesses are not hiring—unemployment has been above 9.5% or higher for 16 months; and the economy grew at just a 2% annual rate in the third quarter.

Enter quantitative easing, the process of pouring more dollars into the economy by purchasing Treasuries. This is the Fed's second round, leading to the popular epithet of QE2. Its effects are a little less apparent than those of interest rates, but it has important implications for agriculture.

### The Theory

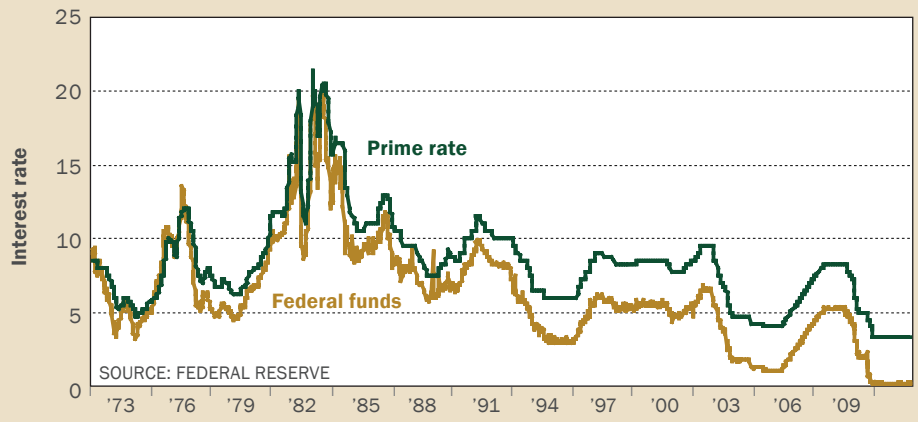
The Fed's move will encourage investors to put their money into riskier assets, such as stocks, bonds, businesses or real estate as they seek higher returns, explains Vincent Reinhart, a former monetary affairs director at the Fed and now a resident scholar at the American Enterprise Institute in Washington, DC. This is one reason for money flowing into commodities.

"QE says the Fed is not out of ammunition and can still help the market and provide stimulus to the economy through a bigger balance sheet," he says.

It is seeking stimulus because some fear the U.S. will slide into a deflationary/stagnant economy similar to Japan's since the early 1990s, in the wake of the bursting of bubbles in its stock and real estate markets. Consumer prices in Japan have fallen in seven of the past 10 years.

Some inflation is desirable when the economy needs a boost because it

### Federal Funds Rate is at Zero; Prime Rate Reflects Risk Premium




*With the federal funds rate at zero, the Federal Reserve can't reduce interest rates further to encourage lending. Meanwhile, banks are adding a risk premium to their lending rates, as shown by the relatively large spread between the Federal Funds rate and the Prime Rate.*

# ONOMY?

encourages people to buy now rather than later. It also means that consumers' income may rise while fixed-rate debt remains unchanged, leading to a better standard of living. Finally, prices of products a company makes may rise faster than their costs, leading to higher profits.

In the U.S., the Fed watches the personal consumption expenditures price index, which does not include food or energy. It recently has been rising at about a 1.2% to 1.5% annual rate; 1.7% to 2% is desired.

Put simply, the definition of inflation is too much money chasing too few goods, says Reinhart. "Hence, the Fed's infusion of cash into the economy is designed to provide plenty of dollars to chase the goods that are available."

### Critics

A key criticism of the plan is that the Fed is pumping money into an economy already awash in cash. U.S. commercial banks have more than $2 trillion in reserves, held at the Fed or as Treasuries and other securities.

Like pouring fertilizer onto a field that

## Bullish for Agriculture

"More dollars flowing into the economy should cause the weakness in the dollar to continue," says Dan Basse of AgResource in Chicago. "That makes U.S. assets—including ag commodities—cheaper and boosts exports, an important factor for agriculture." When the Fed made its QE2 announcement, the dollar fell to a 28-year low against the Australian dollar, for example. That is bullish for commodities, Basse says. Indeed, when the Fed made its QE2 announcement, the Reutters-Jefferies CRB (commodity) Index rose to a two-year high and U.S. farmers are expected to enjoy record net cash income.

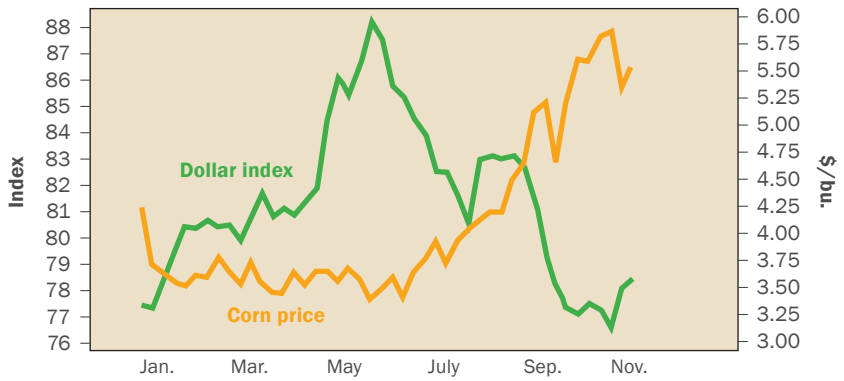
As one example, corn prices tend to move opposite the dollar (see chart)—and the longer the period you look at, the stronger the relationship. It is little wonder, then, that USDA forecasts fiscal year 2011 ag exports at a record $126.5 billion, up from the $108.7 billion exported in the 2010 fiscal year.

For those seeking direct and long-term investment in commodities, farmland comes to the forefront. "The farm belt is our emerging market within the bigger economy," says Vincent Reinhart of the American Enterprise Institute. "Money flows into smaller, less liquid markets. The inflow is large relative to the small market and drives up prices. The banks support leveraging in the market, inflating asset values. Everyone assumes they will keep going and borrows against future appreciation."

Country banks are being cautious, however. Although they have ample funds, they are being selective in their lending. Banks are requiring farmers to provide more documentation of creditworthiness than ever before, including risk management and marketing plans.

So far, farmers have avoided the temptation to increase leverage and have kept debt at relatively low levels. But control of their most important asset—land—is critical and in a bullish world in which competition for that asset is hot, it will be increasingly difficult to keep a cool head. One Iowa grower comments, "it depends whether you believe we are at 1975 or 1981 in this cycle."

### Corn Price Tends to Move Opposite the Dollar Index




*Because corn prices tend to move opposite the dollar, a weak dollar generally is associated with strong corn prices. It is not certain whether this is caused by money chasing commodities, stronger exports or both.*

SOURCE: DTN

doesn't need it, pouring more cash into an economy that isn't using what is available is pointless. "Loans are desirable when businesses see opportunities to make profitable investments that will allow the prepayment of the loan. Similarly, consumers borrow when they expect future income to allow them to repay the loan and be better off," says John Hussman, of Hussman Funds. "Broadly speaking, these are not the case right now. Instead, businesses and consumers see their debt burdens as too high relative to expected income, and are trying to deleverage to improve their long-term financial stability."

Hussman also fears the dollar devaluation "threatens a destabilization of international economic activity, a loss of confidence and the creation of a boom–bust cycle that may choke off any recovery that does emerge."

He notes that the Fed's goal of supporting U.S. jobs through greater exports and more expensive imports may not work perfectly: "Imports have been much more elastic in response to currency fluctuations than exports," he says. "A further devaluation in the dollar would create a negative wealth effect for U.S. consumers facing higher prices for imported goods."

| | |
|---|---|
| 80.38 | U.S. Dollar Index, NY Board of Trade |
| 0.25 | Federal Funds Rate for bank-to-bank lending |
| 0.76 | One-year Libor rate, based on Euro dollars |
| 3.25 | Prime Rate that applies to commercial borrowers |

Inflation expectations already are fueling commodity hoarding, at least on paper. This is benefiting U.S. agriculture right now, but some fear it would be easy for the economy to overshoot the Fed's target.

### Time for Fiscal Policy

Hussman advocates fiscal responses instead: extending unemployment benefits, ensuring predictable tax policy, expanding productive spending such as improvements to infrastructure, supporting public research, increasing efforts to restructure debt, and expanding incentives and tax credits for private capital investment, research and development.

"Long-term economic prosperity is created by carefully allocating savings to productive investments that increase the output of goods and services that meet the needs of consumers and generate the income needed to buy that output," he says. "Everything else is bubble chasing."

Kevin Warsh, a member of the Fed's Board of Governors, also points at Congress: "The Federal Reserve is not a repair shop for broken fiscal, trade or regulatory policies. Given what ails us, additional monetary policy measures are poor substitutes for more powerful pro-growth policies."

### Slow Growth Likely

It would not be surprising to see a decade of slower economic growth ahead, based on a study by Carmen and Vincent Reinhart of 15 major economic crises, the Great Depression and the 1970s oil price shock. They report that real per capita GDP growth rates are several percentage points lower during the decade following severe financial crises and their attendant worldwide shocks.

During the first three years following the 2007 U.S. subprime lending crisis (2008-2010), median real per capita GDP income levels for all the advanced economies has been about 2% lower than in 2007. This is comparable to the median output declines in the first three years after the 15 severe post World War II financial crises, the Reinhart study reports. However, during the current crisis episode, recessions have been deeper, more persistent, and more widespread.

"At this time, the hardest thing for governments, investors and consumers alike to distinguish is how much of the current economic malaise is temporary and how much is permanent," says Vincent Reinhart. Clearly, the answer has far-reaching implications not just for monetary policy but for fiscal policy.

*"The Federal Reserve is not a repair shop for broken fiscal, trade or regulatory policies. Monetary policy measures are a poor substitute for more powerful pro-growth policies."*

# Martin, Goodrich & Waddell Land Listings

***All acreage and mileage figures listed here are approximate***

## ILLINOIS PROPERTY

### Boone County

- **52.5 acres. Nimtz Farm,** contiguous to City of Belvidere. $22,500/ac.

### Bureau County

- **74.85 acres. Dalzell Farm,** 3 mi. W of LaSalle. $8,650/ac.

### Champaign County

- **200 acres. Cappel Farm,** 3 mi. W of Grange. $7,750/ac. *Sale pending.*

### DeKalb County

- **190 acres. Donnelly Farm,** 3 mi. SW of DeKalb. $8,900/ac.
- **40 acres. Donnelly 40 Farm,** 3 mi. SW of DeKalb. $8,900/ac.
- **76.45 acres. Estate of Roy Marsh Farm,** 1 mi. E of DeKalb. $9,300/ac. *Sale pending.*
- **160 acres. MRB Grain Farm,** 1.5 mi. SW of Waterman. $8,750/ac.
- **128 acres. Mary Wesson Farm,** 6 mi. S of Shabonna. $8,650/ac.

### Kane County

- **94 acres. Gurke Farm,** 3.6 mi. W of Elgin; abuts forest preserve. $18,000/ac.
- **161.7 acres. Motz Farm,** 0.25 mi. E of Elburn. $13,500/ac. *Sale pending.*

### Kendall County

- **343 acres. Route 126 Farm,** 4 mi. E of Yorkville. $18,000/ac.

### LaSalle County

- **149.66 acres. Becker Farm,** 0.5 mi. E of Mendota. $7,900/ac. *Sale pending.*
- **220.8 acres. Packard West Farm,** 8 mi. NE of Ottawa. $5,611/ac. *Sale pending.*
- **75 acres. Rex Farm,** 4 mi. E of Mendota. $8,650/ac. *Sale pending.*

### Lee County

- **64 acres. Barber Farm,** 1 mi. SE of Paw Paw. $5,450/ac.
- **208.13 acres. Borell Farm,** 12 mi. N of Mendota. $6,250/ac.
- **5 acres. Franklin Grove Lot,** 18 mi. W of Rochelle. $130,000. *Sale pending.*
- **157.06 acres. LetB Pitcher Farm,** 5 mi. SW of Dixon. $3,900/ac. *Sale pending.*
- **209 acres. Scully Farm,** 12 mi. SW of Dixon. $4,450/ac. *Sale pending.*

### Our Feature Farm

### MRB Grain Farm, 1.5 mi. SW of Waterman

**160 acres. There is approximately 0.75 mi. of road frontage on Leland Road, 0.5 mi. on Rueff Road, and 0.25 on Preserve Road. Excellent location, just 20 mi. W of Aurora.**

- **36 acres. Shaddick Farm,** 4 mi. S of Paw Paw. $6,900/ac.

### Macon County

- **38.33 acres. Decatur Farm,** 1 mi. N of Decatur. $8,650/ac.

### Ogle County

- **171.3 acres. Baker Farm,** 3 mi. N of Byron. $6,900/ac. *Sale pending.*
- **162 acres. Deprin Farm,** 7 mi. SW of Rockford. $6,150/ac.
- **37 acres. Emery Farm,** 8 mi. SW of Rockford. $6,150/ac. *Sale pending.*
- **56 acres. Gill Farm,** 5 mi. S of Rockford. $7,900/ac.
- **17 acres. Land Investment Development Sale Farm,** 4 mi. N of Rochelle. $10,500/ac.
- **255 acres. Lindenwood Farm,** 10 mi. S of Rockford. $6,900/ac. *Sale pending.*
- **82.81 acres. Prairie Ridge Farm,** 1 mi. SE of Oregon. Abundant wildlife, including deer and turkey. $5,700/ac. *Sale pending.*
- **104 acres. Ritz Farm,** 1 mi. W of Byron. $6,250/ac. *Sale pending.*
- **42 acres. SV School Farm,** 6 mi. S of Rockford. $6,300/ac.
- **144 acres. White Pines East Farm,** 4 mi. W of Oregon. $4,500/ac. *Sale pending.*

### Will County

- **78.5 acres. Smith Road Farm,** 2 mi. E of Manhattan. $29,500/ac.

### Winnebago County

- **191 acres. Castle Farm,** contiguous to City of Rockford. $9,900/ac.
- **197 acres. Dickinson #1 Farm,** contiguous to the City of Rockford. $6,900/ac.
- **83 acres. Dickinson #2 South,** contiguous to City of Rockford. $16,000/ac.
- **35 acres. Dickinson #2 North,** contiguous to City of Rockford. $13,900/ac.
- **79 acres. Goldie Palm Farm,** 3 mi. S of Winnebago. $4,500/ac. *Sale pending.*
- **104.6 acres. Holverson Farm,** 0.5 mi. W of Durand. $6,475/ac.
- **179 acres. McKnight Farm,** 0.25 mi. S of Cherry Valley. $8,500/ac.
- **70 acres. Pelley Road Farm,** immediately W of Rockford. $12,900/ac.
- **422 acres. Smith Farm,** contiguous to City of Rockford. $8,500/ac.
- **76 acres. Tate-Latham Farm,** 4 mi. NW of Rockford. $5,200/ac.
- **15.4 acres. Tipple Road Farm,** just west of Rockford. $7,900/ac.
- **342 acres. Westfield Oaks Farm,** 3 mi. S of Winnebago. $4,900/ac. *Sale pending.*

## WISCONSIN PROPERTY

### Walworth County

- **232 acres. Corporate Ridge Business Park,** 0.25 mi. N of the Wisconsin–Illinois border. $9,900/ac.

## MONTANA PROPERTY

### Eastern Montana

- **4,320 acres.** $420/ac.
- **4,000 acres.** $420/ac.
- **1,400 acres.** $420/ac.
- **7,200 acres.** $420/ac. *Sale pending.*

*For details on these properties, call Jeff or Josh Waddell at 815-756-3606 or visit our website at www.mgw.us.com.*

*Commentary by Jeff Waddell, President, Martin, Goodrich & Waddell Inc.*

# Farming Offers New Risks, NEW REWARDS

Agriculture today is a high-stakes game. Production costs are at record levels and the potential for profit has never been higher. On the other hand, given price volatility, margins for some may be slim. With the huge investment required, risk has taken on new meaning—and traditional approaches to managing risk may not be appropriate any longer. Here's how the landscape has changed.

1. In general, the U.S. and the world are running on tight supplies as demand grows. In its November supply–demand report, for instance, the U.S. Department of Agriculture showed the following stocks-to-use ratios for the 2010 crop year:

| Crop | U.S. | World |
|---|---|---|
| Corn | 6.2% | 15.4% |
| Soybeans | 11.4% | 24.1% |
| Wheat | 34.7% | 25.9% |
| Cotton | 20.0% | 20.8% |

At the same time, livestock producers are not following typical cyclical growth patterns as they react to higher feed costs. This is leading to stronger than expected livestock and meat prices.

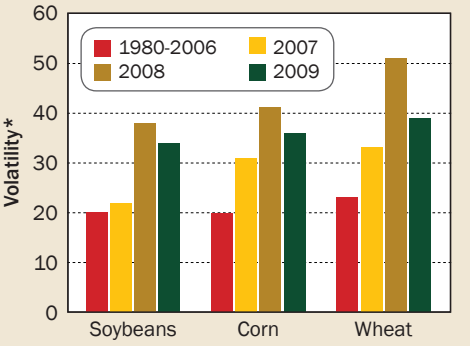
2. Prices are volatile for both inputs and production. In calendar year 2010, for example, looking at weekly prices reported by retailers, fertilizer price changes ranged from 13% (dry potash) to almost 50% (monoammonium phosphate or MAP). Urea's range was $100 per ton. Consider the difference in production costs and competitiveness of a farmer paying the lowest cost versus one paying the highest.

Likewise, based on weekly charts, the corn price range for the life of December 2010 futures was $3.09. At the national average 154.3-bu. yield, that's a potential $477/acre difference in income. For November 2010 soybeans at 43.9 bu., the advantage to a producer who sold near the top versus one who sold near the bottom was $222.

3. Traditional risk-management strategies may not work today. Not long ago, farmers could capture discounts on inputs by ordering early. That strategy may still work for seed and crop protection but in many cases, it isn't even possible to order fertilizer much ahead of the desired delivery date because retailers don't want to carry inventory.

On the marketing side, price volatility means the potential for huge margin calls to maintain production hedges if prices rise. At the same time, it is easy to feel seller's remorse if a grower leaves money on the table. Purchasing options sidesteps margin calls but high volatility also means expensive premiums. In both cases, the need for cash flow increases again.

### Price Volatility is Twice the 1980-2006 Average




*Historical volatility is a percentage calculated by taking the standard deviation of the log-differences of the daily settlement price(s) of the underlying commodity over the course of each month. The result is multiplied by the square root of 252 (the number of trading days in a year).*

SOURCE: CME GROUP

**Responses.** All these changes lead to a need to revisit conventional wisdom and seek new approaches that don't leave as much money on the table and keep an operation competitive.

Top producers are doing just that. They are redesigning their businesses to capitalize on niche markets, brand their production, build vertically integrated supply chains, and store more of their inputs and production.

Some are even concluding that they aren't taking enough risk because their margins are too tight and the stakes are too high. Instead of buying the maximum crop revenue insurance, some are self-insuring production losses by purchasing low-cost "disaster" high-deductible policies that cost a fraction of the "save you from even small losses" revenue products. Cash in the bank will help their operations weather minor-loss years.

One large Iowa farmer's response is even more radical. At a time when many are buying machinery to reduce taxes, he is looking for ways to capitalize on the uncertainties mentioned earlier, such as building bins and drying capacity, installing fuel and fertilizer storage. Most importantly, he is building capital reserves. "I'm going to be a contrarian," he says. "I'm not buying new equipment and looking for more land to farm to pay for it. I'm hunkering down and retiring debt so I can eventually fire my banker."

It is an exciting time to be in agriculture. The rewards offered in farming today are high for those who understand the risks and make them work in their favor.

Jeff Waddell
President

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