Farmland Seasons

Fall 2013

MGW Martin, Goodrich & Waddell, Inc.
Real Estate Services

We plant profitable investment ideas in every season

The Liquidation Phase is Over

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Transitional Land: The Liquidation Phase

As a result of the subprime mortgage crisis, a significant part of our focus in recent years has been on assisting banks, developers and private investors in the difficult task of selling distressed transitional properties. Properties termed "transitional" are those that can typically be developed by an "end user" sometime in the next 5 to 15 years. Our firm is in a unique position, serving as a conduit between end users and owners of transitional farmland for the last two decades. The observations we've made over the last several years have led us to conclude the following: the liquidation phase of transitional land is over.

The vast inventory of transitional land that once commanded $30,000 to $100,000 per acre during its heyday in 2006 recently found its bottom in the $8,000 to $12,000 per acre range. The floor placed beneath these falling prices was provided by the historic surge in the value of farmland—an asset that has been steadily increasing at a rate of 20 to 30 percent per year for the last several years.

The lower sales prices of transitional land have generated a renewed interest from land buyers. Over the past 12 months, our sales team has worked with an increasing number of investors that are willing to pay a slight premium above agricultural land values to own transitional properties. Moving forward, we expect this trend to continue, and we anticipate more buyers will enter the marketplace. Let's pause and reflect on how we got here.

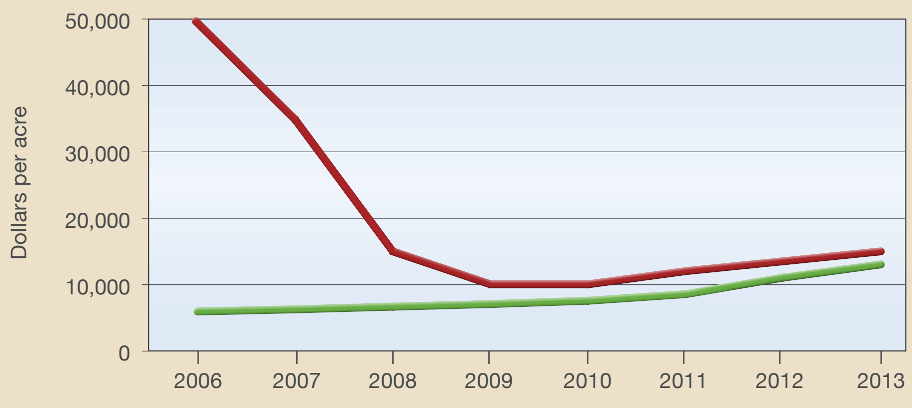
2006

In the first half of 2006, the lion's share of our efforts centered on working with developers, land owners, municipalities, and builders to complete transitional land sales and acquisitions. This unique position allowed us to make an early prediction for our clients and customers—"be prepared for what is to come".

As we now know, the party ended in August of 2006. The days of moving into a home and watching its value go from $250,000 to $300,000 in a year's time were over. The roaring housing market peaked in July as the adjustable rate mortgages fueling the boom in housing developments and home values came due. Individuals purchasing their homes with no money down and a 3.0% interest rate now found their interest rate climbing beyond their ability to continue making payments. Because of this, developers suddenly found themselves with a logjam of excess inventory and no buyers.

Jeff Waddell, president of MGW, Inc. noted in our fall 2006 Seasons newsletter that, "Major real estate developers—who were primary drivers behind the powerful 1031 exchange market in the past three years—have hit the "pause" button on buying more land inventory. They're selling already constructed homes and building out land they acquired earlier." All of a sudden, builders shifted their attention from new transitional land acquisitions to only building out existing lots. We saw a number of developers and builders bail out of land purchase contracts they had entered into the

Farmland vs. Transitional Land Values



High quality transitional land values decreased rapidly following the sub-prime mortgage crisis and found their bottom during 2009 and 2010 as high quality farmland values approached record highs.

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is Over

By Mark Mommsen & Josh Waddell

previous six months. The majority of these contracts were to purchase transitional farmland anywhere from $25,000 to $100,000 per acre, depending on the parcel's proximity to utilities, population centers, transportation and employment opportunities. Our winter 2006 Seasons noted that, "Demand for urban development is taking a breather, but other buyers are stepping up bids for, "close-in" land." Cash investors viewed this time as an opportunity to purchase future development potential at a discount.

2007

Investors in late 2006 unfortunately had reason to step in and take advantage of what they perceived as an opportunity to capitalize on a temporary market fluctuation. In fact, Federal Reserve Chairman, Ben Bernanke, stated in July 2007, "There will be significant losses associated with subprime mortgages, but these losses should be regarded as bumps along the road of market innovation." This was hardly an adequate warning of what was to come. As we now know, the subprime mortgage crisis was the direct cause of the collapse in home values, the loss of equity, the decrease in demand for home construction, and the increased supply of transitional land.

When the market realized the damage to the housing market was more widespread than originally thought, remaining investors headed to the sidelines. As time went on, the depth and complexity of the problems with the housing market were more fully understood. The unexpected increase in housing inventory led to a further decrease in transitional land prices, and this time, investors were less willing to make offers on transitional land—they began to view this market as a falling knife. Jeff Waddell noted in our fall 2007 Seasons, "A lot of land ready for immediate development is already down by 30 to 50 percent. Investors seeking these properties don't think that's far enough. Some of them tell me they expect a 60 to 70 percent decline from the peak in development land values. That's when they say they'll start purchasing. I don't think most people would believe this could ever happen, but I do."

2008

A reeling transitional land market found no relief in 2008. The unexpected, overnight collapse of investment banking giant Bear Sterns sent shockwaves through every sector of the global economy. The downfall of Lehman Brothers, insurance titan AIG, Wachovia and others followed in the coming months. Pandemonium ensued, as it was anyone's guess as to who was solvent or if one's money was safe in even the "strongest" institution. This high level of caution carried over into all aspects of the U.S. land market. Buyers were not able or willing to obtain loans, and sellers simply could not procure offers

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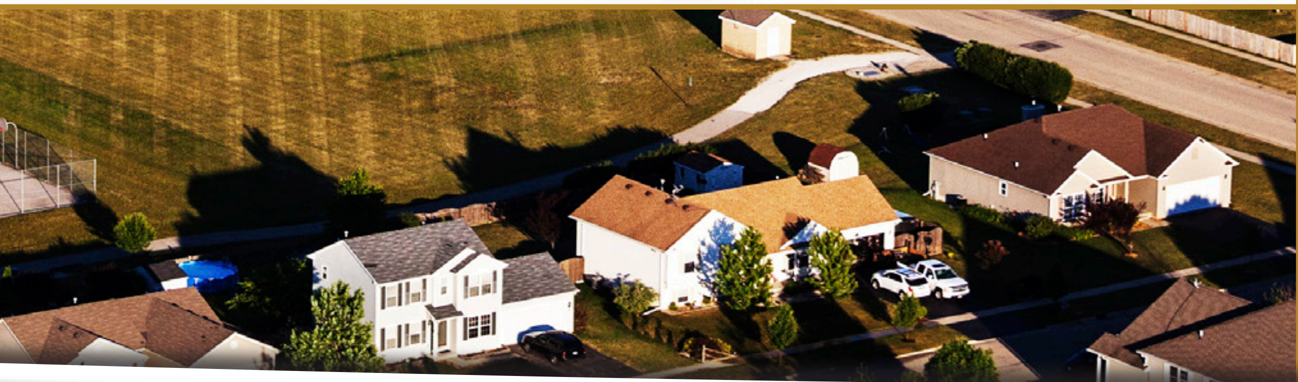

News Flash:

The U.S. produces over 50% of the world's soybeans, 32% of the world's corn, over 30% of the world's cotton, and 10% of the world's wheat. *Source: Foreign Agricultural Service/USDA*

During Colonial times, one U.S. farmer fed four other people. Today, one U.S. farmer produces food for 130 others.

In a stunning reversal of course, the U.S. Tax Court has agreed with the IRS that the signing of a CRP contract and being in compliance either personally or via an agent makes the landowner's CRP payments subject to self-employment tax. "The implications of the court's decision could be far reaching by subjecting mere passive investors in farmland and non-farming heirs to self-employment tax on CRP rental income," says Iowa State University extension ag law expert Roger McEowen.

near their asking prices. Investors across the board were not willing to part with cash for fear of continued downward prices and a period of slow economic activity.

In an unprecedented move, the U.S. Government and Federal Reserve began their "bailout" programs in hopes of propping up the U.S. economy. Further measures—known as QE1—then began the massive injections of cash into the U.S. money supply that still continue today. This signaled to many investors that the likelihood of increased future inflation was real—and they began to move their money into hard assets like land and gold.

At this time, we were able to accommodate this influx of new interest to the farmland market as there was a steady supply of quality farms available for sale. High quality farms in 2008 were being purchased for $6,500 to $8,000 per acre, depending on their location. These purchases provided buyers with a 4 to 6 percent cash return on their investment, as well as stability and the hedge against inflation they were seeking. Meanwhile, problems continued to persist in the transitional land market. As Jeff Waddell noted in our winter 2008 Seasons, "Some lenders are carrying loans of $25,000 to $40,000 per acre on development land, which I would find hard to liquidate today for much more than farmland values."

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2009

As banks looked to shore up bad bets from previous years, they severely restricted lending to even the most solid investor. Gone were the days of a private individual placing 25 to 30 percent down to purchase land. Banks now demanded as much as 50 percent down. It became nearly impossible to turn on the television or read a newspaper without hearing doom and gloom reports about the future of the United States economy. Needless to say, the brakes continued to be firmly applied to the transitional land sales market.

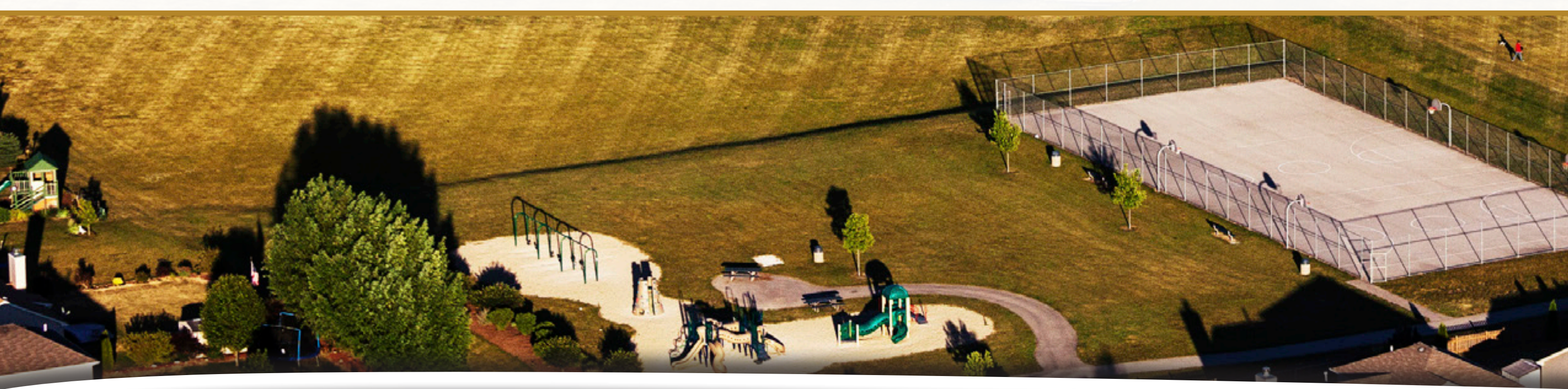
For the first time since the mid 1980's, we saw a slight correction in farmland values of about 0.5 percent. Despite this, agricultural land outperformed nearly every other asset class in terms of security of capital and consistency in returns. This was especially impressive considering the global panic and chaos due to the collapsing financial scene—the closing of powerhouse companies, the tightening of bank lending standards, and the withdrawal of deposits by ordinary Americans in hopes of preserving that which they had saved.

Keep in mind, a 0.5 percent correction was very attractive to investors in the agricultural land market. Nearly all other investment alternatives were losing 10 to 90 percent of capital value in as little as 12 months. Because of this, a number of progressive investors, embarking on a strategy of hedging against inflation and preserving capital, directed additional funds into farmland purchases. These investors could foresee that a return of 4 to 6 percent on a farmland investment would far exceed the high risk of stocks and nearly 0 percent returns from traditional safe havens such as government bonds and bank deposits. For the first time, "big money" woke up to the benefits of owning and operating agricultural land.

2010-2011

The Federal Reserve announced in late fall of 2010 that it would purchase $600 billion of long-term Treasuries, at a rate of $75 billion per month. That program, popularly known as "QE2", signaled a further printing of money and a continued flight to hard assets by investors. This announcement further encouraged investors to continue efforts in hedging against inflation and protecting existing capital. In other words, the pumping of billions of dollars by the Federal Reserve into the U.S. economy would eventually have to make its way into the money supply. As a result, there would be more dollars chasing a finite amount of goods, thereby raising asset prices and decreasing the purchasing power of the U.S. Dollar.

While buyer demand increased significantly for farmland in 2010, the transitional market continued in a state of flux with buyers and sellers trying to make sense of what the future held. Buyers at this time were few and far between, only willing to purchase transitional land if they could do so at or slightly above farmland prices.



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These investors, both farmers and absentee buyers, were making cash offers and closing quickly on these distressed properties. This offering was an attractive proposition for landowners who, for the first time since 2007, were met with the real possibility of finding cash buyers for their land.

In previous years, many buyers shied away from transitional land investment, as it often came with its own set of issues. For example, many of these parcels had been stripped of topsoil, had water drainage issues, or had been left fallow when farming was not the highest and best use for the property. Although the immediate cash return on transitional lands at this time was less than what buyers were receiving on farmland investments, investors were willing to accept the lower return in exchange for the chance at future upside should the property be developed.

During 2011, we worked with an increased number of sellers ready to sell their transitional land holdings. With an uncertain future as to how long it might take for demand to reach its previous level, many sellers, who now understood the sheer amount of inventory of mature lots and annexed land, felt it was time to entertain the prospect of selling their distressed holdings. Capitalizing on record farmland prices, which were placing the floor under transitional land values, seemed a more feasible approach than waiting the 5, 10, or 20 years it may take to realize the level of price the property had been worth during the 2006 peak.

2012-2013

The historic run-up in agricultural land values continued through 2012 as buyer demand reached a frenzied pace. During this time, we heard from countless "non-traditional" land buyers on a very frequent basis. This new group of investors was competing in the marketplace against farmers who had been experiencing years of record farm income. This high level of buyer competition, combined with a historically low inventory of farms for sale, pushed agricultural land prices to record highs. Record commodity prices, coupled with low interest rates, resulted in the continuation of a limited number of farms available for sale.

As ag land prices have risen, so have the premiums being placed on transitional land. The market for transitional land has shown new strength and more consistency in the past 12 months. We are now being contacted regularly by buyers seeking to purchase transitional land on the edge of town and they are willing to pay a premium. This is in contrast to previous years in which buyers were seeking farmland and were pleased with the potential for future upside, although it was not a requirement for them.

We cite a number of examples of properties we sold in 2013 that underscore this trend. The following properties were purchased at a premium of 10 to 20 percent over agricultural land value by investors looking for a mid to long term investment in future land development.

- *January 2013, Ogle County, IL: $13,200 per acre, 127 acres with rail access and interstate frontage*
- *February 2013, Winnebago County, IL: $10,150 per acre, 127 acres adjacent to several subdivisions*
- *May 2013, Will County, IL: $16,500 per acre, 55 acres within the city of Frankfort, Illinois*
- *May 2013, Kane County, IL: $13,500 per acre, 152 acres formerly slotted for a residential subdivision*
- *November 2013, DeKalb County, IL: $15,000 per acre, 73 acres adjacent to an industrial park*

We expect this trend to continue at a much more measured pace than what we saw in the early 2000's. The majority of buyers and sellers are operating today with a great deal more caution, as the sting caused by the collapse from 2006 is fresh in our memories. As the U.S. economy continues to improve, albeit very slowly, we expect an increased number of investors to provide adequate demand for transitional properties that offer future upside potential.

North American oil has set off a supply shock that is sending ripples throughout the world, according to the International Energy Agency (IEA). This is helping to ease a market that was relatively tight for several years. The technology that unlocked the bonanza in places like North Dakota can and will be applied elsewhere, potentially leading to a broad reassessment of reserves.

The dollar is expected to continue to be the "currency of choice" as it gains strength against the other major currencies. The Federal Reserve's hints to begin tapering its stimulus efforts (as unemployment numbers improve) contrast sharply with expectations that European central banks and the Bank of England will continue to ease monetary policy and the Bank of Japan will continue with aggressive stimulus.

Martin, Goodrich & Waddell Inc. Ranked as One of America's Best Brokerages

Martin, Goodrich & Waddell Inc. was recently named one of the 2012 America's Best Brokerages by The Land Report, which identifies itself as *"The Magazine of the American Landowner."*

The Land Report's editors noted MGW has sold more than 500 farms in the last 10 years, with 2012 brokerage sales in the $80 million range.

This is the third annual survey of the country's leading real estate firms specializing in land. MGW also was given this honor in last year's survey for the team's depth of expertise, specifically its experience in farmland, transitional land, development land and recreational land.

"Over the past several years, we have continued our efforts to expand our reach as a land company, having worked in many areas of the U.S., including: Illinois, Iowa, Indiana, Wisconsin, Missouri, Arkansas, Montana, Tennessee and Florida," says Jeff Waddell, president, MGW. "We feel especially appreciative of this honor given the limited land inventory available for sale in recent times. For 2013, we are on track to close more land transactions than any year in our 38 year history. Moving into fall 2013, we continue to see strength in land values. In a time of rapidly changing markets, the need for a highly experienced land professional is greater than ever. As always, we invite anyone interested in land to call upon us at any time."

Mark Mommsen Earns ALC Designation

Martin, Goodrich & Waddell, Inc. broker and auctioneer Mark Mommsen has been named an Accredited Land Consultant (ALC) by the Realtors Land Institute. Recognized throughout North America as the top designation for land real estate specialists, Accredited Land Consultants have earned a reputation for being individuals who have achieved the highest level of education, experience and professionalism in the industry.

"I take pride in continually improving my skills, abilities and knowledge in the land business," Mommsen says. "Whether dealing in agricultural, recreational or transitional real estate, the expertise gained through the ALC program can be applied. Each of these land classes requires a unique approach to valuing, marketing and selling."

Part of the designation requirement is the completion of a rigorous education through the Realtors Land Institute. This includes extensive study and experience with land investment analysis, tax deferred 1031 exchanges, land marketing and negotiating.

"Landowners are becoming more diverse in their backgrounds and needs," Mommsen adds. "These buyers and sellers are located across the U.S. as well as internationally. Just this summer, I had the opportunity to work with clients on 1031 exchanges, land investments in IRA accounts and the assemblage of land parcels in targeted areas. These are things I enjoy greatly and have a passion for. Because of this, I remain dedicated to offering my best each day."

Martin, Goodrich & Waddell Land Listings

All acreage and mileage figures listed here are approximate

Hinckley Farm Auction, 9/20/13 DeKalb County, IL

338 total acres, 322 tillable acres. Offered in 2 tracts and as a whole property. Highly productive soils. 188 Optimum Corn Productivity Yield, 139 Productivity Index. Adjacent to the south side of Hinckley, Illinois. A premium quality DeKalb County farm with future development potential.

ILLINOIS PROPERTY

BOONE COUNTY
- **141.1 acres. LJ Farm & Home,** 2½ mi. NE of Poplar Grove. $13,500/ac.
- **78.7 acres. Bates Road Farm,** 2¼ mi. S of Belvidere. $11,250/ac.

DEKALB COUNTY
- **120 acres. Frieders Farm,** 2½ mi. NE of Earlville. $13,900/ac.
- **82.4 acres. Harkness Farm,** Village of Malta. $11,900/ac.
- **5 acres. Donnelly Property,** 1 mi. S of DeKalb. $249,000
- **72.9 acres. WHP Farm,** contiguous to Sycamore. $15,900/ac. *Sale Pending*
- **58 acres. Nikolic Farm,** 2 mi. SE of Genoa. $9,900/ac. *Sale Pending*

JO DAVIESS COUNTY
- **160 acres. Hepperly Farm,** 7 mi. SE of Scales Mound. $6,900/ac.

KANE COUNTY
- **203.6 acres. Campton Farm,** 2 mi. NE of Lily Lake. $12,000/ac. **SOLD**
- **155 acres. Plato Road Farm,** 1¼ mi. N of Campton Hills. $14,500/ac. **SOLD**
- **37 acres. O'Brien Road Farm,** 1¼ mi. NW of Hampshire. $10,900/ac.

LASALLE COUNTY
- **79 acres. Ottawa Property,** ½ mi. E of Ottawa. $3,835,000
- **43.1 acres. Corcoran Farm,** 8¾ mi. E of Mendota. $11,450/ac.
- **46 acres. Sheridan Property,** contiguous to Sheridan. $7,400/ac.
- **102 acres. Wallem Farm,** 2½ mi. NE of LaSalle. $14,500/ac. *Sale Pending*

LEE COUNTY
- **400 acres. Danekas Farm,** 3½ mi. S of Rochelle. $10,700/ac. **SOLD**
- **113 acres. Haefner Farm,** 1½ mi. SE of Amboy. $12,000/ac.

MCHENRY COUNTY
- **199.1 acres. Sangiorgio Farm,** 2 mi. N of Union. $14,900/ac.
- **10.5 acres. DiSilvio Farm,** 5 mi. W of Huntley. $355,000.
- **132.9 acres. Rock Creek Development Property,** 4 mi. N of Hampshire. $9,900/ac.

OGLE COUNTY
- **140 acres. Pulpit Rock Farm,** ¾ mi. NW of Grand Detour. $10,725/ac.
- **68.6 acres. Grutter Farm,** 3 mi. NW of Rochelle. $12,275/ac. **SOLD**
- **127 acres. Ogle County Crossroads Property,** city of Rochelle. $39,900/ac
- **93.3 acres. Greffe Farm,** contiguous to Rochelle. $21,900/ac.

STEPHENSON COUNTY
- **149.3 acres. Windmill Farm,** 1¼ mi. E of Freeport. $10,900/ac. **SOLD**
- **375.3 acres. Colberg Farm,** contiguous to Freeport. $6,900/ac.

WILL COUNTY
- **60.3 acres. Ironwood Farm,** 3½ mi. S of Frankfort. $12,000/ac. **SOLD**
- **78.5 acres. Smith Road Farm,** 2 mi. E of Manhattan. $22,900/ac.
- **76.8 acres. Zappia Farm,** 1¼ mi. SE of Monee. $14,900/ac.
- **212 acres. Beecher Farm,** 3¾ mi. NE of Beecher. $11,500/ac.
- **200 acres. Wehmhoefer Farm,** contiguous to the village of Beecher. $10,600/ac. *Sale Pending*
- **54.9 acres. Frankfort Farm,** city of Frankfort. $16,900/ac. **SOLD**
- **67 acres. Arsenal Road Farm,** contiguous to Joliet. $14,250/ac.

WINNEBAGO COUNTY
- **93.9 acres. Castle North Farm,** contiguous to Rockford. $8,900/ac.
- **159.2 acres. Dickenson #2B Farm,** contiguous to Rockford. $19,000/ac.
- **120 acres. Durand Farm,** 5½ mi. SE of Durand. $8,690/ac.
- **20.5 acres. Farm School Road Farm,** 5½ mi. SE of Durand. $190,000.

INDIANA PROPERTY

LAKE COUNTY
- **135.5 acres. Crown Point Property,** Crown Point. $14,760/ac.
- **110 acres. Green Acres Farm,** 2 mi. NW of Hebron. $8,990/ac.
- **81 acres. Minder Property,** 1 mi. E of Merrillville. $11,900/ac.

NEWTON COUNTY
- **98 acres. Roselawn Farm,** contiguous to Roselawn. $7,000/ac. **SOLD**

MISSOURI PROPERTY

HOWELL COUNTY
- **424.9 acres. Smith Property,** 14 mi. S of West Plains. $1,150/ac.

WISCONSIN PROPERTY

RACINE COUNTY
- **77.3 acres. Racine County Horse Property,** 5 mi. NE of Burlington. $629,000. *Sale Pending*

ROCK COUNTY
- **55.9 acres. Vineyard Farm,** 2¼ mi. S of Milton. $9,900/ac.
- **18.3 acres. Rotamer Ridge Farm,** city of Janesville. $12,900/ac.

WALWORTH COUNTY
- **125 acres. Dietzler-20 Farm,** 4 mi. W of East Troy. Price Reduction, $6,100/ac.
- **35 acres. Dietzler-A Farm,** 4½ mi. NE of Elkhorn. Price Reduction, $6,900/ac.
- **67 acres, Dietzler-ES Farm,** 5 mi. NE of Elkhorn. Price Reduction, $6,300/ac.
- **35 acres, Dietzler-T Farm North,** 1¾ mi. E of La Grange. Price Reduction, $6,700/ac.
- **59 acres, Dietzler-T Farm South,** 1¾ mi. E of La Grange. Price Reduction, $6,900/ac.
- **48 acres, Dietzler-B Farm South,** 4 mi. NE of Elkhorn. Price Reduction, $6,950/ac.
- **144 acres, Dietzler-B Farm North,** 4 mi. NE of Elkhorn. Price Reduction, $7,750/ac.

AUCTIONS
- **80 acres. Goodwin Farm,** contiguous to Rochelle, IL. 9/18/13
- **338 acres. Hinckley Farm,** adjacent to Hinckley, IL. 9/20/13
- **40 acres. Park-ER-Woods State Street Property,** ½ mi. W of Rockford, IL. **SOLD**
- **262.3 acres. Richard Seyller Estate Farm,** 6 mi. N of Annawan, IL. **SOLD**
- **116.8 acres. Beere Property,** 5 mi. NE of Burlington, WI. **SOLD**
- **74.5 acres. Mt. Pulaski Farm,** 6 mi. W of Latham, IL. **SOLD**

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

FARMLAND INVESTING:
PERSPECTIVE IN A TIME OF CHANGE

It's been an interesting year. Throughout 2013, we've seen wet areas, dry areas, and even farms that didn't get planted. Although this year's crop yields are yet to be determined, it seems we're on our way to replenishing the low stocks of previous years. Beyond agriculture, the lingering effects of the Great Recession continue to hang on as many hard-working Americans seek jobs and often struggle to make ends meet.

While we never know what the future holds, I see many reasons to be optimistic, especially in the ag land market. Today's market is built on a foundation of strong fundamentals. Sure, interest rates might change and commodity prices will fluctuate, but it is reasonable to expect the global demand for U.S. grains to continue to get stronger as the world's population increases. The productivity of U.S. ag land is higher than anywhere in the world, producing over 40% more corn today on average than in the early 1990's. And, our farmers are among the best in the business. Their ability to implement rapidly changing technology allows them to run highly efficient operations, impressive in their scope and size. As we have observed in the past 7 years, farmland, like gold, has provided a "flight to safety" for many investors looking to protect themselves against the tidal wave of uncertainty our nation has experienced. I don't believe this trend will end anytime soon—especially for farmland, as it provides a consistent, annual cash yield.

The land market over the last several months has continued to show amazing strength and resilience as we work to understand the impacts of changing commodity prices, an uptick in interest rates, and yield projections for 2013 and beyond. If we do see average to above-average yields this fall, and lower grain prices persist, that's not necessarily a bad thing. A temporary correction in commodity prices will build demand for commodities, allowing U.S. ethanol plants and livestock producers to enhance their profitability in the marketplace—a major challenge for them in recent years. This is a vital component to American energy independence as well as an opportunity for expansion in the U.S. livestock industry.

I would expect these changes in the ag industry to provide more balance and stability in our land market. Balance is necessary for long-term strength. Even if the rapid increase we experienced in recent years for farmland values and cash rents take a pause, that's OK. These fluctuations have happened before and they will happen again—it's a result of free markets, of which I am a strong proponent. So, as you work to make sense of what's to come, I remind you that the great strength of investing in land is that it's a marathon, not a sprint. This season's changes provide next year's opportunities.

Jeff

Jeff Waddell
President

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