



Is Crop Insurance Propping Up Land Values?

Take crop insurance out of the Midwest this year, and the financial picture for many growers would have been bleak. There was early speculation the drought would force a drop in cash rents, and even farmland values. Then someone got out a calculator and did the math. Talk about a mood changer.

Today, the USDA is forecasting net cash income for U.S. farmers to be \$139.3 billion for 2012, up 3.4% from 2011. Government payments directly to producers will total \$11.1 billion, a 6.3% increase from 2011. The 1.1 million crop insurance policies purchased this season, at a cost of more

than \$4 billion to farmers, provided \$114 billion in liability protection. In some areas, where losses were heavy, early estimates projected revenue-protection policies on corn could return \$40 for every \$1 a farmer invested. About half of all policies were expected to trigger a claim.

Is the financial impact of the crop insurance program so strong that it is artificially propping up today's historically

high land values? Gary Schnitkey, professor of farm management at the University of Illinois, says not at all. He believes crop insurance simply takes some of the volatility out of the market. It hasn't changed the direction of the game, it's just cut out some of the blood loss.

In Illinois, the farm-management specialist says about 60% of the 2012 crop acres were covered under revenue-protection policies at the 75%, 80% or 85% levels. Participation in the program has climbed as commodity prices and market volatility have increased.

Amid this volatility, Schnitkey says a case can actually be made that today's farmland market is underpriced, even with cropland prices up an average of 14.5% across the U.S.

"Between 1987 and 2010, farmland prices and capitalized

values were close. Today, however, capitalized values are well above farmland prices. That suggests the fundamentals support higher farmland prices than we are currently seeing in the market here in Illinois," he explains.

The difference between capitalized values and average farmland prices in the state reached about \$4,537 per acre in 2012. A widely used formula sets capitalized value equal to cash rent divided by an interest rate. Schnitkey uses the Treasury Constant Maturity 10-year rate. Low interest rates are a big factor in the wide margin of difference, he says.

"Right now, farmland prices are supported by cash rents and low interest rate levels," he explains. "If we see a decrease in farmland returns or increases in interest rates, that could lead to overall price decreases. At this point, neither seem imminent. In my opinion, it's rising interest rates that pose the largest risk to farmland values."

Jeff O'Hara, agricultural economist with the Union of Concerned Scientists, says while he is not anti-crop insurance, he does have concerns about the program and its effect on agriculture, including land prices.

"Our concern with crop insurance is that it doesn't really spread the risks, it just transfers the risks to the taxpayers," he says. "We'd like more diversity in agriculture to mitigate that risk. When you look at corn, we have ethanol and high fructose corn syrup. Both are just price supports for corn that encourage overproduction."

It's this overproduction more than the income from crop insurance that will ultimately hurt land values, O'Hara says. Crop insurance, he believes, alleviates the natural risk that goes along with farming.

He describes crop insurance as "guaranteed income without the risk" for certain commodities. The system discourages diversification and creates a system he says is unsustainable without government assistance.

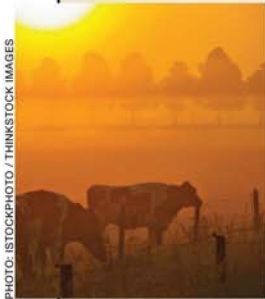


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