Making Sense of Land Prices

With the exception of the high interest period in the mid 1980s, farmland values have steadily increased every year since 1970. This trend has accelerated in the past several, with land prices skyrocketing in many areas of Manitoba. Nobody can predict the future, but producers need to ask if it's going to be profitable to buy more land at these prices; if it's more practical to rent land; or if it's best to hold firm and not expand.

From a straight profitability perspective, it's useful to look at a potential land purchase from the basis of marginal analysis. You need to consider if you are making or losing money on that piece of land. If you are losing money, spreading the loss out will decrease profitability over the whole farm, even if it makes the loss seem smaller.

For example, to buy an extra 160 acres of land at $2,500 per acre and finance 90 per cent of it at five per cent over 20 years would mean interest payments of $17,900, or $112 per acre, in the first year alone. In addition, principal payments of almost $11,000 would be due in the first year and, while not an actual expense, it needs to be considered for cash flow purposes. By the fifth year of the loan, interest payments would be down to about $97 per acre. So there would be no profitability on that purchase.

You may want to think about paying cash rent if the prices are right for your budget. To calculate this, plug in a rent price for the land and determine marginal profit/loss for that field. Fixed costs (land, machinery, storage) will often break a farm budget and need to be properly calculated so expansion decisions can be made with confidence.

The decisions are challenging because nobody can predict what returns will be year to year. Some other considerations that may influence a land purchase decision are:

- Is the land undervalued and would it provide your farm with an instant boost in net worth?
- Will your financial position and debt service capacity allow you to weather possible short term losses for longer term budgeted profits and/or net worth growth?
- Can you afford to take on more debt?
- Do you have a surplus cash position and are you looking for an investment opportunity? Higher down payments on land will lower borrowing costs and make future payments more manageable.

Acquisition of more land, buying or renting, is affected by many factors. Profitability analysis should be the most important consideration. It's important not to let the fear that you'll lose your chance and someone else will get the land influence your decision.

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Manitoba