

News To Grow On



September 2004

A Look At Farmland Prices

This past year, the high prices of farmland sold in eastern Nebraska has become a hot topic, with land selling at or above all time highs; sometimes \$500-700 per acre more than just one year ago.

These increases are reminiscent of farmland value increases during the late 1970's and the major decline in values during the early 1980's, prompting many to ask the question, "Are land values going to remain at these high levels, or are we setting up for another major drop in values?" To answer this question, it is helpful to compare the economic environments during the late 70's and early 80's to present times.

In the late 70's, the economy was experiencing double-digit inflation with modest interest rates. The value of farmland was increasing up to 20% or more on an annual basis. In most cases the decision to purchase was based on the premise the land would be worth more the next year. The name of the game in the late 70's was "leverage;" buying land with little cash down and high levels of borrowed money at variable rates. Because the value of land was increasing at a faster rate than the rate of interest paid on the debt, little attention was paid to whether the purchase would cash flow.

In the early 80's, it was apparent the overall economy could not continue to function with a high level of inflation. Inflation was brought down by tightening the money supply, resulting in a sharp rise in interest rates, with farm real estate loan rates climbing to 15% and farm operating rates to 20%.

The combination of high debt and high interest rates proved lethal to cash flows. At the peak, a typical debt of \$2,400/A (80% loan of a \$3,000/A purchase) at an interest rate of 14.5% resulted in a \$348 per acre interest bill at the end of the year. The end result was a major drop in land values; the land was liquidated to help reduce debts to a manageable level.

Fast forward to today: land values are again at or above historic levels, but the key economic factors impacting land values in the early 80's are much different. We are experiencing historically low interest rates and inflation. Additionally, the balance sheet of the agricultural sector as a whole is much stronger; with a higher overall equity position and a lower overall debt load. Most importantly, cash flow is once again a key factor. With a land purchase today, it is typical to see a larger down payment, and subsequently, less debt per acre. Thus a \$3,000/A purchase today may only result in a debt of \$1,800/A. At 6% interest this results in a bill of \$108/A at year end - a much more friendly cash flow number. Even at the \$2,400/A level mentioned above, an interest bill would only be \$144/A (over \$200/A less than the early 80's). This is certainly more manageable from a cash flow standpoint.

The current conditions of low interest rates, low inflation, and a modest debt-to-asset ratio in the ag sector create stability in the overall ag economy in comparison to the adverse conditions of the late 70's and early 80's. While today's stability is no guaranteed indicator land values will continue to increase, it suggests that a repeat of a major land value decrease is not in the picture at this time.

*Contributed by Glenn Baumert
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A Message from the Ag Loan Department of Union Bank

We would like to introduce you to "News To Grow On," the new semi-annual agricultural newsletter from the Ag Division of Union Bank & Trust Company. Our objective is to provide you with industry-related updates as well as information on new products & services offered by Union Bank. We hope you find the information relevant to your farming/ranching operation.

As always, please contact your Union Bank office for assistance with any of your banking needs, including loans, deposit services, trust services, online banking, electronic banking, college savings, and more. You may also find our website to be an informative and helpful financial tool; visit us on the web at www.ubt.com.

To all of our Ag customers: We want to take this opportunity to wish you a safe harvest and to thank you for your continued business.

401(k) Advice: Go “Solo”

Union Bank & Trust Company has been providing retirement plan services to businesses across Nebraska for over 30 years. One retirement program we offer to our valued small business customers is the **Solo 401(k) Plan**. The Solo 401(k) Plan is ideal for farm businesses with self-employment income or for small businesses organized as corporations.

The Solo 401(k) Plan may offer you the ability to shelter the maximum amount allowed from taxation by the IRS. Plan participants who own and operate a farm business may be able to shelter up to 25% of earned income or compensation, plus \$13,000 in pre-tax 401(k) contributions in 2004 (\$16,000 if you are 50 or older), up to the lesser of 100% of compensation or a maximum of \$41,000. These Solo 401(k) Plan limits are significantly higher than the tax-deferred savings opportunities currently available using IRAs or SEP-IRAs.

The Solo 401(k) Plan is a convenient program that is easy to start and easy to maintain. We will work with you every step of the way to make sure your Solo 401(k) Plan is designed to meet your needs. To learn more about this program, contact Doug Weishahn in Lincoln at (402) 323-1691.

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