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DARROCH VALUATIONS
VALUERS & PROPERTY ADVISERS

Fattening Farm Prices Set to Cool Off

➲ Less Exposed to Commodity Price Fluctuations

Prices for fattening farms are expected to show signs of cooling when QV releases its latest rural statistics early next month. There has been a lot of heat in farmland prices in recent years but falling commodity prices and a gloomy economic outlook is now impacting on the rural sector, with a re-adjustment in farm prices underway. Across the wider rural market there is a consensus that farm prices need to drop back, however it is anticipated that certain market sectors will be subject to greater price falls. Overall, the fattening sector (sheep & beef) is expected to show less volatility than its dairy counterpart as wider economic factors impact.

Dairy farms will most likely be the hardest hit, with fattening farms feeling pressure but possibly escaping the brunt of any decline. Much of this has to do with fluctuating world commodity prices. The fattening sector has not been subject to the 'roller coaster' price ride of the dairying sector, but will still feel some repercussions from its readjustments. Final farm prices for 2008 are still likely to be 'elevated' given market buoyancy earlier in that year, but 2009 prices are expected to show marked declines.

World commodity prices have a major impact on New Zealand rural real estate. Market players have shown a willingness to pay premium rates for farm land when commodity prices track up, irrespective of whether that price is sustainable. The price spike in dairy products in 2007 was clearly matched by record prices for dairy farm land. Now commodity prices have returned to more normal levels and farm prices are expected to re-adjust as well.

Some investors who purchased farms at premium rates in 2007/2008 expecting high payouts could now be facing serious cash flow issues. Federated Farmers noted that in 2007 (a drought year when many farmers faced extra feed costs) producing 1kg of milk solids was estimated to cost a farmer $4.54. The viability of some farm operations is therefore in question given Fonterra's latest forecasted payout of $4.55 per kg for the 2009/2010 season. In the event of ongoing hardship, it is probable that some forced sales might appear which in turn could accelerate the fall of farm prices.

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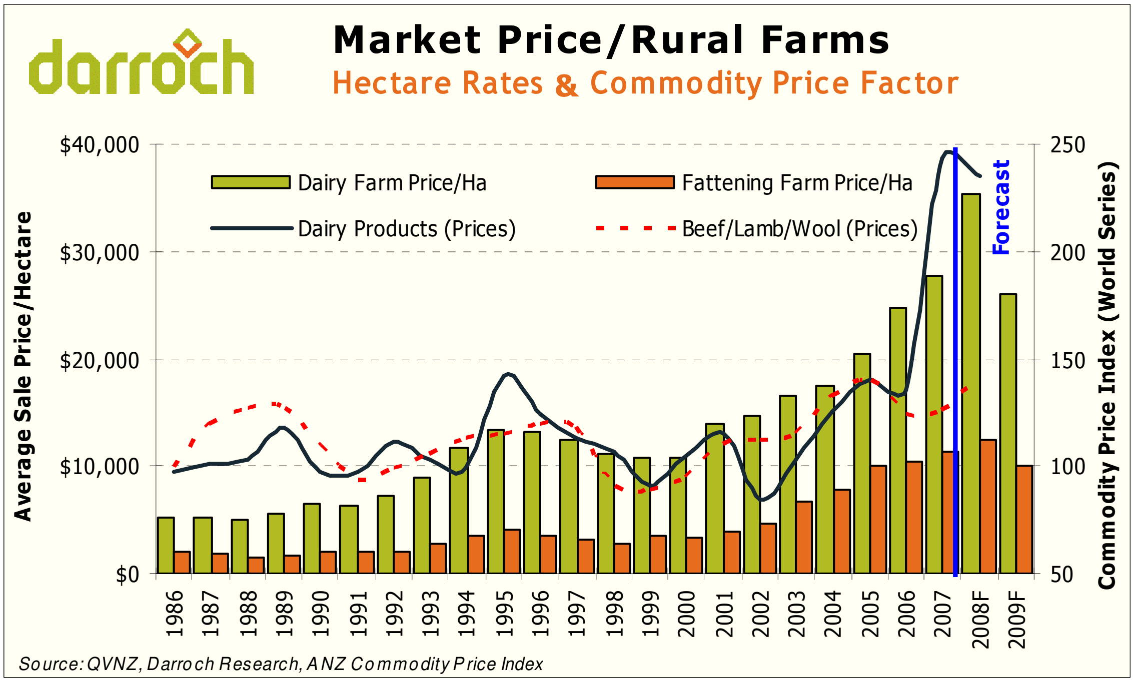
World commodity prices for sheep/beef products have shown some fluctuations too, but generally prices have been less volatile than with dairying. Farm prices tend to mirror commodity price movements closely (see chart below) and although prices for lamb/beef products have improved of late, fallout from the dairying sector and a weak global economy look set to impact on the fattening sector.



One of the major issues for fattening farms has been the alternate use value of land i.e. demand for conversion to dairying where contour, access and water supply allows. The impact of this has been particularly notable since Fonterra's inception and subsequent higher income for dairy farmers. Fattening farm land prices have increased from $3,000/hectare in 2001 to almost $12,000/ha in 2008. With market readjustments now underway in the dairying sector, demand for conversions looks set to take a back seat for a while leading to downward price pressure on fattening farms as well.

We anticipate that the price will probably fall back towards $10,000 per hectare, although this needs to be balanced against the direction of lamb/beef commodity prices. More buoyant prices generate market optimism and help cushion price falls. On the other hand, a sustained weak global outlook and local economy could depress land prices further.