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Dirt Cheap? Investors Are Plowing Into Farmland, Here's Why

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Here's a phrase you don't hear so often:
multimillionaire farmers.

If you've read my column, you know that I often try to shine some light on whatever "alternative" or esoteric investment has captured the attention of wealthy families and institutions. Well, hold on to your straw hats, because one of the most interesting investments to catch their fancy recently is farmland.

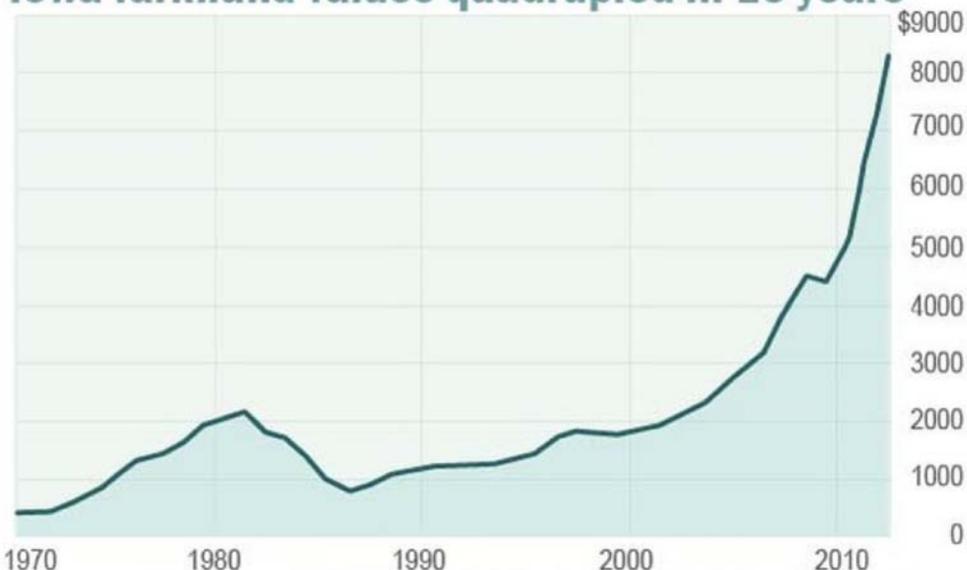
The best indexes of land values come from Iowa, which has nearly 31 million acres of farmland. In April an outfit called the Iowa Farm & Land Chapter #2 Realtors Land Institute (chew on that mouthful) said its survey of local farmland brokers put the average price of the highest-quality farmland there at \$11,674 per acre. Even the midgrade dirt was fetching \$8,300 per acre. While those prices were down 5 percent or so from a year earlier, they are still

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way, way up over the long run. In the late 1990s you could buy midgrade farmland for less than \$1,700 per acre.

Iowa State University also provides a good survey of land values. It reports that a landowner who bought in 2000 and sold last year would have earned a 12.6 percent annualized return on his investment — and that is not including the proceeds from farming the land or leasing it out to a farmer.

Iowa farmland values quadrupled in 10 years



Source: Iowa State University Extension and Outreach Land Values Survey

Yep: Farmland has solidly beaten the stock market (http://ycharts.com/indicators/iowa_farmland_value/chart/#/?securities=include:true,id:I:IAFV,,id:%5ESPX,include:true&calcs=&zoom=10&startDate=&endDate=&format=indexed&recessions=false&chartView=&splitType=single&scaleType=linear&stockListId=&stockListSymbol=) since the late 1990s. So there are many millionaire farmers around Iowa. After all, the average size (<http://www.iowaagriculture.gov/quickfacts.asp>) of a farm there is 333 acres, meaning the average Iowa farmer tilling his own high-grade soil has an asset worth \$4 million. So the next time you pass through Waterloo or Story City, show the guys in overalls some respect, even if they're not carrying pitchforks.

To be sure, it's not the farmers themselves who are driving the boom in prices. As I mentioned, it's the money pouring in from outside investors. The smart money wants to own hard assets that are critical to the maintenance of advanced industrial civilization. Among these core assets necessary for human life is, obviously, the production of food. Huge institutional investors ranging from sovereign wealth funds to university endowments to the Mormon church have been heavily investing in farmland not only in the United States but around the world (particularly in Africa and South America) for a while now.

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So, if you believe in following the smart money, farmland must be a solid investment. But if you're not entirely convinced, I can't blame you. In fact, I can think of several reasons why investors should think carefully before plowing their money into the heartland soil.

First of all, as with every investment, a lot depends on timing, your personal level of involvement and your expertise. Timing is especially critical, and anybody looking at farming has to be concerned that they missed the bumper returns of the last decade. A year ago some observers were already worrying (<http://www.marketwatch.com/story/farmland-bubble-10-year-rise-raises-red-flags-2013-10-21>) about a bubble in farmland prices.

Farmland bulls (the investment kind, not the bovine kind) would reply that farmland is an asset with constrained supply in a world with increasing demand for quality food, which makes it a buy, or at least a hold. On the other hand, farmland prices have already started to level out. As I mentioned, they're down something like 5 percent this year, thanks at least partly to a 50 percent-plus decline in corn prices (http://ycharts.com/indicators/corn_price/chart/#/?securities=include:true,id:I:USCFPR,,&calcs=&zoom=5&startDate=&endDate=&format=real&recessions=false&chartView=&splitType=single&scaleType=linear&stockListId=&stockListSymbol=)). So bearish investors can reasonably argue it's time for getting out while the getting's good.



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Buying a chunk of prime Iowa farmland has become an expensive proposition.

As land values flatten (and begin dropping in some of the most valuable areas), it's also important for some owners of farmland to begin thinking a little more like bond investors or commercial property owners. That is, they should be mindful not just of the potential capital appreciation they can receive from their asset but also the income it generates.

As I alluded to above, farm owners are often absentee owners. Most of them collect income from their farmland not by planting corn or soybeans and selling the crops but rather by renting it out to an actual farmer who handles that side of things. According to Michael Duffy, a retired economist from Iowa State University, the amount of owner-operated land in Iowa dropped from 55 percent in 1982 to 40 percent in 2012. More importantly, the percentage of land farmed through a cash rent agreement more than doubled during that period, from 21 percent to 46 percent.

The problem for these absentee investors is that, while farmland values have been skyrocketing, cash rents have not. In Iowa, cash rent as a percentage of land value dropped

(<http://www.extension.iastate.edu/agdm/wholefarm/html/c2-09.html>) from 5.9 percent in 2000 to 3 percent in 2013. So the land has delivered significant capital gains, but it's producing income levels its owners could achieve in a simple bond portfolio — and less than the income yields generated by fancy office skyscrapers in New York City.

I'm not saying people who refuse to sell are making a mistake, mind you. Many people who own quality farmland know infinitely more about its particularities than they do about owning skyscrapers in New York City. And, for a lot of investors, the decision to own or sell farmland goes beyond the financial calculations. Many Americans, especially those who were born into farm families, find tremendous psychic and emotional value in owning farmland.

I know this firsthand, in fact. I watched my dad, now 77, return to farming on our family land in Kansas after his retirement from the Navy. While he may be sacrificing some income potential — we've been

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... averaging better than a 5.5 percent tax-equivalent yield on our family land —
Dad gets enormous emotional value from working that land. This type of
return can't be calculated on a spreadsheet. It absolutely plays an important
role in the retirement math for many farm owners.



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