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Return to Iowa farmland versus S&P 500

Abstract

This paper examines the returns to Iowa farmland relative to the returns from the stock market.

Keywords

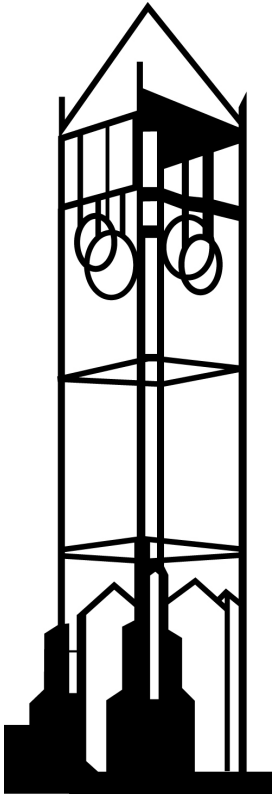
farmland, Iowa, land values, investments, S&P 500, return on investment

Disciplines

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Return to Iowa Farmland Versus S&P 500

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**Comparing the Stock Market and Iowa Land Values:
A Question of Timing
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The recent increase in Iowa farmland values has resurrected a perennial question. Which is a better investment—the stock market or farmland?

Iowa farmland values have shown yearly increases for eleven of the past twelve years. The values remain at record high levels where they have been for the past nine years. Based on the Iowa State University Land Value Survey, the 2011 estimated average farmland value in Iowa was \$6,708 per acre. This was an increase of 32.5 percent from the 2010 estimate. Since 1990, the estimated average value of Iowa land has risen more than fivefold, going from \$1,214 to \$6,708 per acre.

The composite value of the stock market, as measured by the Standard & Poor's Index (S&P) average, has started recovering from the disastrous 2008 year. Even though the S&P lost almost 32 percent of its value between 2000 and 2008, its overall record has been impressive since 1990. Stock values rose from 328.75 in 1990 to a December 2010 close of 1,243.32, an increase of nearly 400 percent in spite of the decline in 2008.

To determine which option provided the better investment, this paper compares and contrasts the returns to farmland and the stock market since 1960. It also discusses some of the important factors to consider over the next few years.

DATA

The returns to land or stock shares are composed of two parts. The first is capital gains or the increase in value. Obviously, this also could be a capital loss if values decrease. The second component is yearly returns.

Owning land has an unavoidable annual ownership cost not associated with stocks. Property taxes must be paid and should be included in a comparison of owning stocks or farmland. Additionally, if farmland is held as an investment and not by an owner-operator, there could be a professional farm manager involved and the fee for this service would have to be considered. There is also a need for some maintenance and insurance with farmland not associated with owning stocks.

The data used for this analysis comes from different sources. The Iowa average land values come from the yearly Iowa State University Extension publication FM 1825. The average farmland rental rate was obtained from USDA/Economic Research Service (ERS) in the Land Use, Value, and Management briefing room. The average land tax per acre is calculated using data from ERS farm income data. Taxes per acre were calculated as the real estate taxes paid divided by the total number of acres.

The Standard & Poor's averages and yearly dividends for 1960 to 2011 were taken from the web site of Dr. Robert J. Shiller at Yale University. The value used is the December close of each year. (<http://www.econ.yale.edu/~shiller>)

A few assumptions are necessary to determine which provides the better investment. It is assumed \$1,000 is invested in each alternative at the end of the year. The amount of land or stock purchased will depend on the existing value. For example, in 1960 the average farmland value in Iowa was \$261 per acre. So, for \$1,000, 3.83 acres could have been purchased.

A second assumption is that all the net land rent or the dividend earned in any year will be reinvested in the land or the stock market. This will increase the number of units held. To continue the example above, average Iowa farmland rent in 1961 was \$17.10 per acre. Average taxes in 1961 were \$3.79 per acre. Using a 7 percent of gross rent management fee and a 6 percent of gross rent charge for insurance and maintenance, the net return per acre in 1961 was \$11.08.

The net rent in 1961 represented a 4.25 percent return. For the \$1,000 investment this would be a return of \$42.50. In 1961, the average land value had remained unchanged at \$261 per acre. If the entire return were invested back into land, .16 acres could have been purchased. So, at the end of 1961 the investor would have 3.99 acres worth \$1,042. This process is repeated each year in the analysis.

Land taxes, a management fee, insurance and maintenance are the only ownership costs considered for land. There is no ownership cost assumed for stocks. No transactions costs or other costs are considered in this analysis.

The annual percentage changes since 1960 in the S&P and Iowa land values reflect considerable yearly variation in both investments. Land values changed an average of 7.3 percent with a standard deviation of 12.4 percent. Yearly percentage change for land ranged from a negative 30.1 percent to a positive 32.5 percent. The Standard & Poor's yearly closing value showed an average percentage change of 7.6 percent with a standard deviation of 16.5 percent. The yearly percentage change in the S&P ranged from a negative 40.7 percent to a positive 35.0 percent.

The yearly return to land after taxes, management fee and insurance and maintenance has averaged 4.5 percent of land values since 1960. The standard deviation of the yearly return to land has been 1.1 percent. The maximum yearly return was 7.9 percent while the low was 2.5 percent. The Standard and Poor yearly dividend has averaged 3.1 percent of the S&P closing level from 1960 to 2011. The standard deviation was 1.2 percent, the maximum yearly return was 5.4 percent and the lowest yearly return was 1.2 percent over the same time period.

Analysis

Figure 1 shows the return to \$1,000 invested in 1960. At that time, \$1,000 would have purchased 3.83 acres or 17.6 shares of the S&P. Using the assumptions above, an investor at the end of 2011 would have 34.20 acres worth approximately, \$229,396 or they would have 78.36 shares of the Standard and Poor's, worth approximately \$97,427. In other words, the value of the S&P investment would be only 42 percent of the value of the land investment.

There have been periods since 1960 when the returns to the stock market have been higher. However, for the most part, land has shown higher returns over the past 50 years. It is interesting to note the recent dramatic swings in the S&P, as shown in Figure 1.

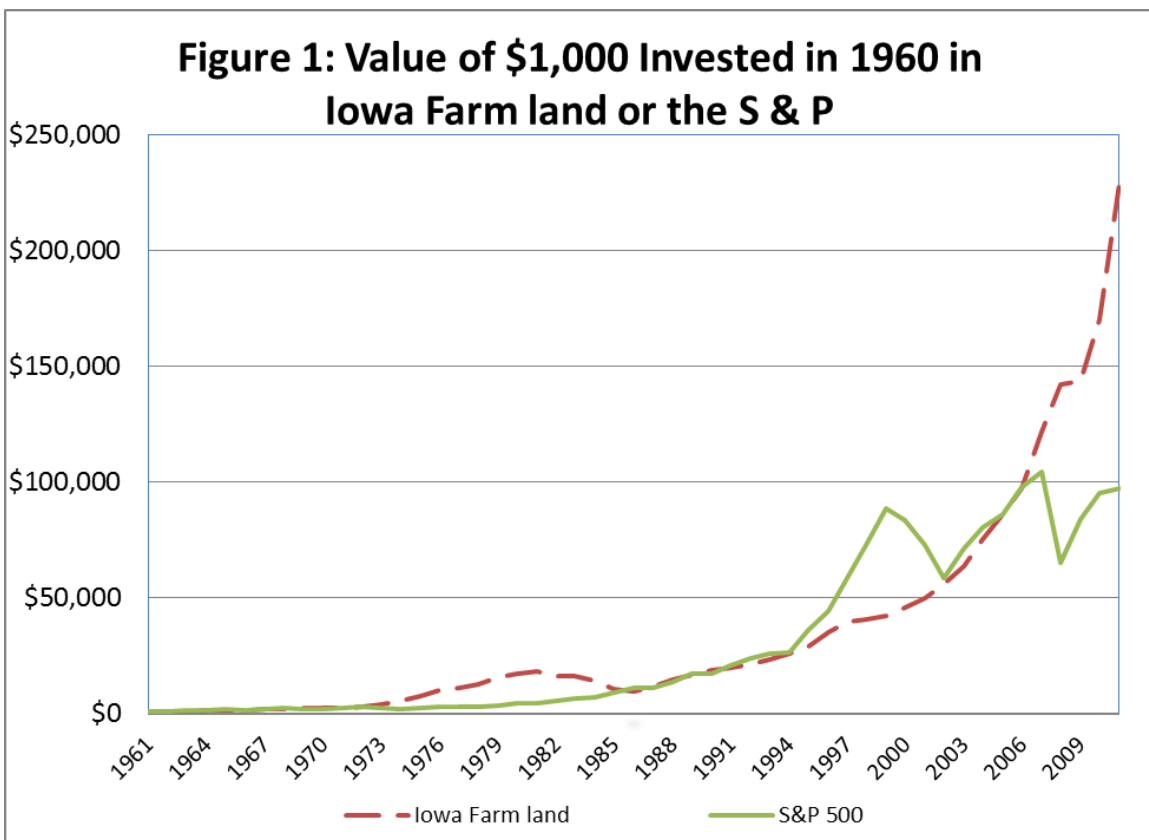


Figure 2 shows what would have happened if the \$1,000 investment in land or the S&P had been made in 1970. At that time \$1,000 would purchase 2.39 acres or 11.1 shares of the S&P. By 2010, the land investment would have been worth \$93,335, while the S&P investment would have been worth \$45,373. An investment made in the S&P in 1970 would be only 49 percent of the value of an investment in land.

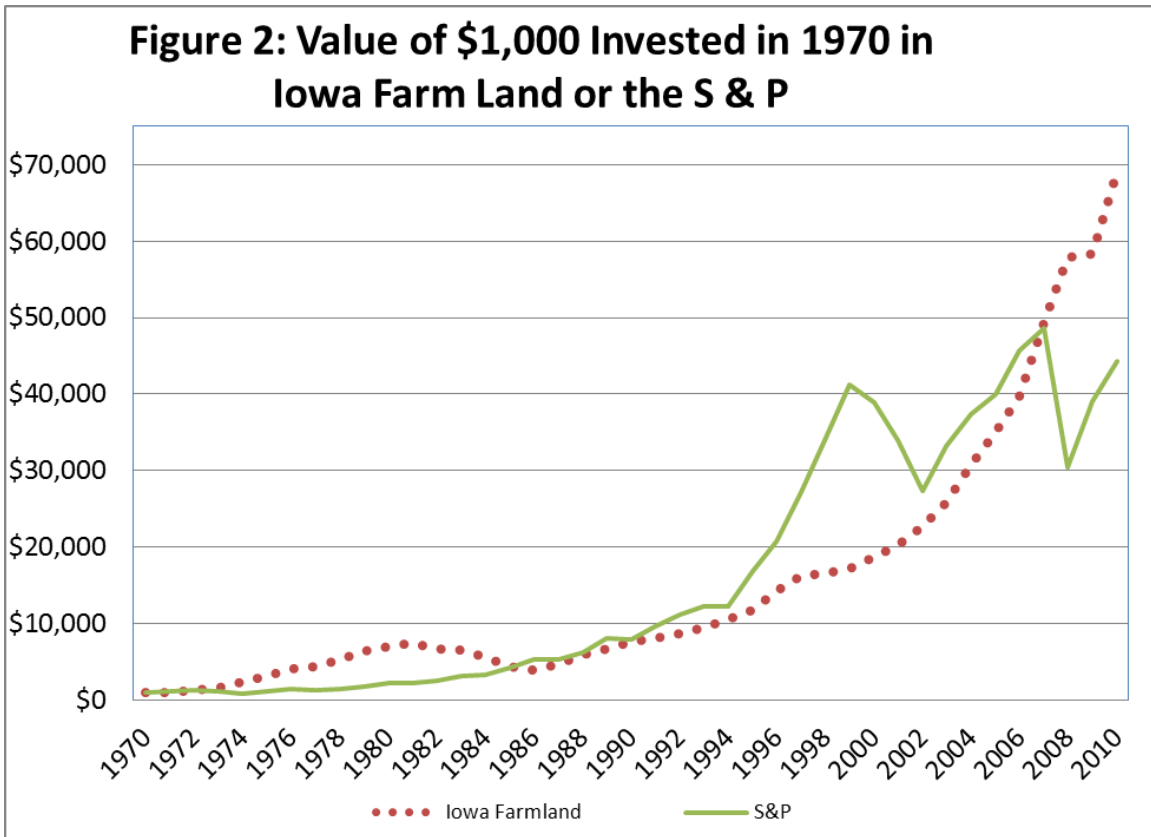


Figure 3 presents the results of a \$1,000 investment had it been made in 1980, near the previous peak in Iowa land values. In 1980, the \$1,000 investment in land would have purchased only .48 acres of land or 7.49 shares of the S&P. By 2010, the land investment would have been worth \$13,275 while the S&P investment would have been worth \$20,187. The land investment would only be 66 percent of the stock market investment.

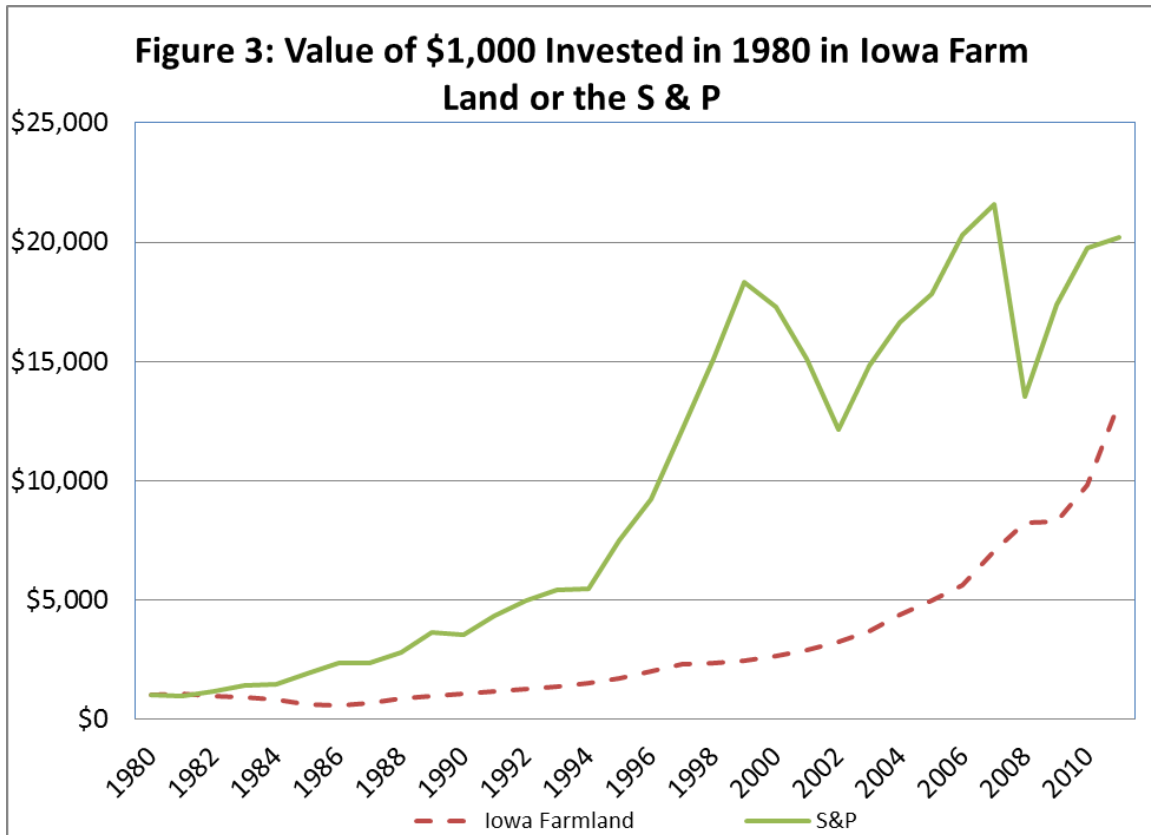
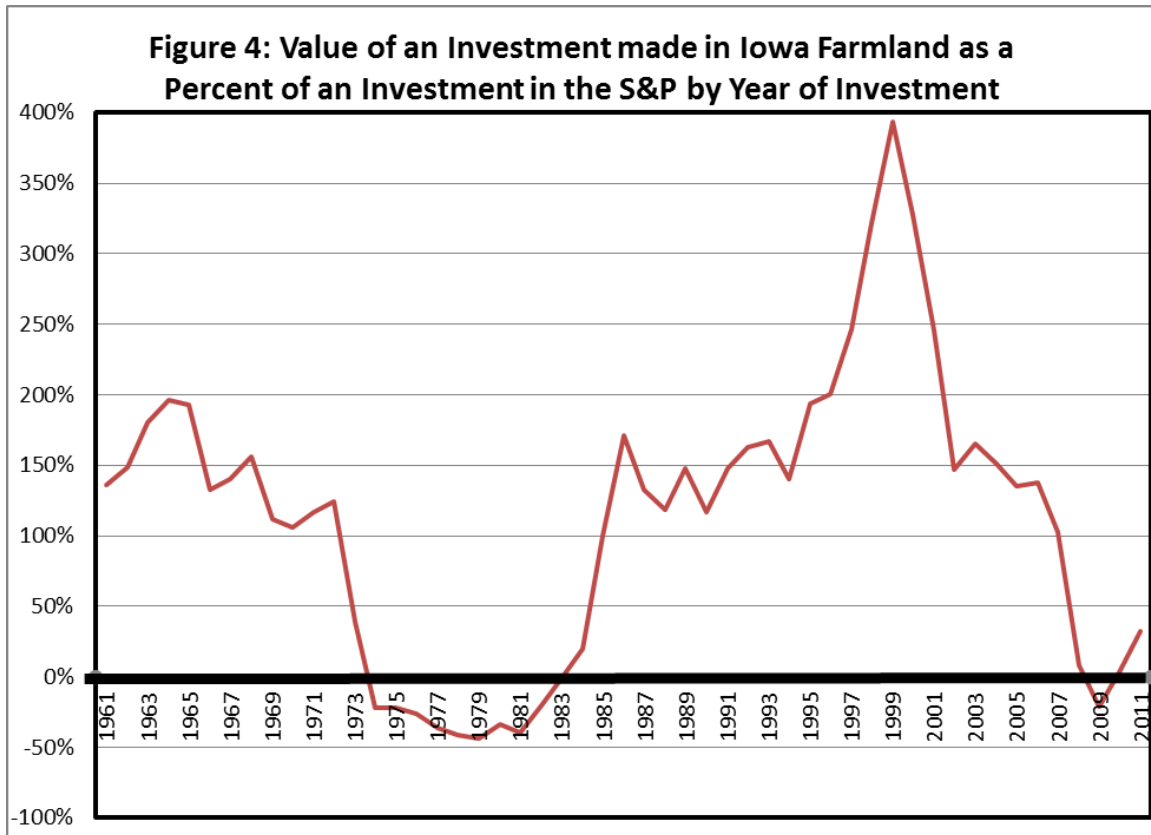


Figure 4 shows a comparison of the returns in 2010 based on the year of the initial investment. This figure presents the returns to Iowa farmland as a percent of the returns to the S&P. If the value is above 100 percent then the farmland would have a higher value, conversely if the value is below 100 percent then the S&P would have a higher value for an investment made in that year.

Figure 4 shows that the timing of the investment makes a difference in which appears to be a better investment. Land would have been the better investment in all years except the period from 1974 to 1984. This period coincides with the rise in land values during the 1970s. Land values in Iowa began their rapid rise in 1973 and peaked in 1981.



Conclusions:

Which is the better investment, Iowa farmland or the stock market, is a complicated question and one for which there is no one best answer. Several factors need to be considered when trying to answer this question and several assumptions have to be made.

In this paper, real estate taxes, a management fee, insurance and maintenance were subtracted from the return to land. These were the only ownership costs assumed for land. There would be other costs that would vary with the individual circumstances.

This study also assumed there would be no transactions costs. There would be costs associated with either the purchase of land or the purchase of stocks.

Finally, this study assumed average performance for land values, rents and for the stock market. Deviations from average performance would produce different results.

The majority of land is purchased by existing farmers. They purchase the land for a variety of reasons that may or may not fit with traditional investment

theory. In spite of this, land, over the long run, has produced competitive, if not superior, returns compared to the stock market.

What will happen to the value of farmland over the next several years? The future is hard to predict, but in this case it is especially difficult. There are several factors that will have an immediate impact on land values and other longer-term factors that will determine the future performance of land.

The value of land is determined by its income earning potential. For the most part, in Iowa, that means the returns to corn and/or soybeans. Returns will be influenced by a number of factors over the next several years. Oil prices, ethanol prices, crop yields, costs of production, economic recovery, alternative biomass sources, and a host of other major issues will have an influence on the price of land.

Another uncertainty in the land market is the changing landowner demographics. In 1982, 12 percent of the farmland in Iowa was owned by someone over 75 years old. By 2007, this percentage had more than doubled to 28 percent. In 2007, over half, 55 percent, of the farmland in Iowa was owned by someone over the age of 65. How this land will be transferred from one generation to the next is not entirely clear at this time. It appears that the majority of it will be passed on to the children, usually in equal shares. This means there will be more landowners and more out of state owners. Whether they will they want to continue to own the land or sell it is unknown. Too much land being offered for sale is not a problem at this time but it could become one if the next generation doesn't want to hold on to the land.

The performance of the stock market for the next few years is also not clear. The impact of the stimulus package and how soon it will be felt are unknown at this time. Further compounding the situation is the impact of government ownership of several major companies.

The budget deficit continues to grow and will place a burden on the economy as the U.S. seeks to find ways to support the level of expenditures and revenues it has seen over the past few years.

The imbalance of trade is another area of uncertainty with respect to possible impacts on the U.S. economy and the performance of the stock market and the land market.

A complete discussion of all the factors that could influence the land or stock market is beyond the scope of this paper. Suffice it to say there is considerable uncertainty as one looks ahead. While uncertainty about the future is not new, there is a level of concern for both the land market and the stock market.

Land and the stock market are different types of investments and assets. This simple comparison was based strictly on averages. There are a number of

individual stocks that perform better than the S&P. But, there are some that don't perform as well. Anyone contemplating the question which is a better investment needs to know their goals.

Lands performance relative to the stock market over the past few years has been spectacular. Will this trend continue, time will tell. Which is the better investment? As the old saying goes, timing is everything in the success of a rain dance.