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Returns to farmland ownership

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Below are estimates of the average returns from owning Iowa farmland since 1970. Annual returns are in two forms: cash income and change in market value. Total return is the sum of these two.

Handbook Updates

For those of you subscribing to the *Ag Decision Maker Handbook*, the following updates are included.

Crop Planning Prices— A1-10 (1 page)

Livestock Planning Prices—B1-10 (1 page)

Please add these files to your handbook and remove the out-of-date material.

Cash returns

Cash rental rates are used as estimates of the cash returns to farmland. The rate of cash return (percent) each year is computed by dividing the cash rental rate by the market value of land.

Cash rental rates are a gross return, not a net return, because property taxes and other ownership expenses have not been deducted. These will probably reduce the total return by one to two percentage points.

Increase (decrease) in value

Another form of return is the annual increase (decrease) in the market value of farmland. This increase (decrease) is computed as a percentage change in value from one year to the next.

Results over the entire period

Cash returns **—** As shown in Table 1, the rate of cash return has been relatively stable since 1970. Returns dropped to 5.3 percent during the early 1980s due to the rapid inflationary rise in land value. Conversely, the rate rose to 9.7 percent later due to the plunge in land values during the financial crisis of the late 1980s. The average over the period from 1970 to 2002 was 7.5 percent.

Land value change **—** The return due to changes in land values was much more volatile,

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ranging from a high of 36.8 percent in 1977 to a low of negative 28.1 percent in 1985. Over the entire period, land values increased by an average of 5.9 percent per year.

Total returns — The total return (annual cash return plus change in land value) was 13.4 percent per year. It ranged from a low of a negative 19.1 percent in 1985 to a high of 43.1 percent in 1977.

Results by financial period

Rates of return have varied greatly during specific time periods over the past thirty-three years. The rates of return during the farm boom period, farm crisis period and the current period are shown in Table 2.

Farm boom period — During the farmland boom period of 1970 through 1981, land values increased rapidly (15 percent on average) providing a total return of 22.3 percent. It should be noted that cash rental rates and land values for the decade before 1970 were very stable. Farmland values and rental rates started their rapid rise in 1973/74 when grain shortages pushed prices to extremely high levels.

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Table 1. Returns to farmland ownership per year (per acre).

Year	Whole Farm Cash Rent	Market Land Value	Cash Rent as Percent of Land Value	Percentage Change in Land Value	Total Percentage Return
2002	$116	$1980	5.9%	4.2%	10.1%
2001	114	1900	6.0	4.4	10.4
2000	112	1820	6.2	2.8	9.0
1999	109	1,770	6.2	4.1	10.3
1998	109	1,700	6.4	6.3	12.7
1997	106	1,600	6.6	10.3	17.0
1996	107	1,450	7.4	7.4	14.8
1995	102	1,350	7.6	5.5	13.0
1994	100	1,280	7.8	5.6	13.4
1993	102	1,212	8.4	5.1	13.5
1992	101	1,153	8.8	1.2	10.0
1991	97	1,139	8.5	4.5	13.0
1990	96	1,090	8.8	-0.5	8.4
1989	91	1,095	8.3	15.6	23.9
1988	82	947	8.7	20.5	29.1
1987	76	786	9.7	-10.0	-0.3
1986	83	873	9.5	-20.0	-10.5
1985	98	1,091	9.0	-28.1	-19.1
1984	109	1,518	7.2	-3.2	4.0
1983	106	1,568	6.8	-13.0	-6.2
1982	106	1,802	5.9	-7.2	-1.3
1981	102	1,941	5.3	7.2	12.4
1980	96	1,811	5.3	16.8	22.1
1979	89	1,550	5.7	16.5	22.2
1978	82	1,331	6.2	5.7	11.9
1977	79	1,259	6.3	36.8	43.1
1976	69	920	7.5	28.0	35.5
1975	60	719	8.3	20.4	28.8
1974	53	597	8.9	28.1	37.0
1973	39	466	8.4	12.6	20.9
1972	35	414	8.5	5.6	14.1
1971	34	392	8.7	0.0	8.7
1970	33	392	8.4	2.6	11.0

Source: USDA Annual Survey of Agricultural Land Values and Cash Rents.
Cash rental rates for 1995 through 2002 are estimates.

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Table 2. Returns to farmland by time period.

Time period	Cash rent as percent of value	Percentage change in land value	Total percentage return
Boom period—1970-81	7.3%	15.0%	22.3%
Farm crisis—1982-87	8.0	-13.6	-5.6
Current period—1988-02	7.4	6.5	13.9
Entire period—1970-02	7.5	5.9	13.4

Farm crisis period **–** During the farm crisis of 1982 through 1987, land value declined rapidly – an average of 13.6 percent per year. As noted previously, cash returns actually increased during this period because land value dropped faster than rental rates. However, the land value declines more than offset cash returns and the total return was a negative 5.6 percent.

Current period **–** During the period after the farm crisis and up to the current time (1988 – 2002), land values and rental rates resumed their upward trend, although slower than during the boom period. The average rate of return during this period is similar to the average rate of return over the entire period.

Results by alternative land purchase dates

Rates of return on farmland investments vary greatly depending on when farmland is purchased. In Table 3, farmland is assumed to be purchased at three different time-periods; the beginning of the boom period (1970), the end of the boom period (1981) and the end of the crisis period (1987). The rates of return for each of these three investment period are shown in Table 3.

Beginning of boom period (1970) **–** A typical Iowa farmland purchase in 1970 would have been $392 per acre. The value of the farmland 32 years later in 2002 was $1,980, for an increase of 405 percent or 13 percent per year. The average cash return over the period was 22 percent. This was computed by dividing the cash rental rate for each year by the $392 purchase price. The cash return was 30 percent in 2002 when cash rent was $116 per acre.

End of boom period (1981) **–** A farmland purchase in 1981 would have been for $1,941 per acre. The value 21 years later in 2002 was two percent higher. The average cash return over the period was five percent. The cash return was six percent in 2002 when cash rents were $116 per acre.

End of the crisis period (1987) **–** In 1987 farmland value was $786 per acre. The value in 2002, 15 years later, was $1,980 for an increase of 152 percent or 10 percent per year. The average cash return over the period was 13 percent. The cash return in 2002 was 15 percent.

Table 3. Returns to farmland ownership by purchase date

Ownership period	Purchase price	2002 Price	Percent increase in price	Average annual rent as percent of purchase price*
Beginning of boom period to present (1970 – 2002)	$392	$1,980	405%	22%
End of boom period to present (1981 – 2002)	1,941	1,980	2	5
End of crisis period to present (1987- 2002)	786	1,980	152	13

*The cash return per year is computed by dividing the cash rental rate for each year during the time period by the farmland purchase price. An average cash return is then computed for the time period.

Is there a future for legislative involvement in shaping the structure of agriculture?

by Roger McEowen, assistant professor of agricultural economics and extension specialist, agricultural law and policy, Kansas State University.

In *South Dakota Farm Bureau, Inc. et. al. v. Hazeltine*, the U.S. Court of Appeals for the Eighth Circuit upheld the Federal District Court for the District of South Dakota and ruled the South Dakota anti-corporate farming law unconstitutional on "dormant commerce clause" grounds. The opinion is viewed as critical to the future viability of anti-corporate farming restrictions in other states and, more generally, to the ability of state legislatures to shape the structure of agriculture within their borders.

Anti-corporate farming restrictions

Presently, nine states prohibit corporations from engaging in agriculture to various degrees. Recently, consolidation in almost every aspect of the farm economy has further threatened the continued viability of a vibrant, independently owned and widely dispersed farm production sector with the specter of being vertically integrated (largely through contractual arrangements) in the production, processing and marketing functions. Thus, as concentration of agricultural production has accelerated in recent years, legislatures in many of these same states have attempted to legislate protections for the economic autonomy of individual farmers and the environmental health and safety of both the rural and non-rural sectors.

South Dakota provision

The South Dakota restriction dates from 1974, and in 1998 South Dakota voters amended the state constitution (known as "Amendment E") to prohibit corporations and syndicates from owning an interest in farmland (with numerous exceptions). Section 21 states:

> "no corporation or syndicate may acquire, or otherwise obtain an interest, whether legal, beneficial, or otherwise, in any real estate used for farming in this state, or engage in farming."

Section 22 exempts "family farm corporations" or "family farm syndicates" as follows:

> "a corporation or syndicate engaged in farming or the ownership of agricultural land, in which a majority of the partnership interests, shares, stock, or other ownership interests are held by members of a family or a trust created for the benefit of a member of that family. The term, family, means natural persons related to one another within the fourth degree of kinship according to civil law, or their spouses. At least one of the family members in a family farm corporation or syndicate shall reside on or be actively engaged in the day-to-day labor and management of the farm. Day-to-day labor and management shall require both daily or routine substantial physical exertion and administration."

The plaintiffs, a collection of farm groups, South Dakota feedlots, public utilities and other farm organizations, challenged Amendment E on the basis that it would prevent the continuation of their existing farming enterprises unless those enterprises changed organizationally to come within a statutory exemption. Specifically, several of the plaintiffs feed livestock in their South Dakota feedlots under contracts with out-of-state firms and claimed that Amendment E would apply to their out-of-state contracting parties and hurt economically their South Dakota livestock feeding businesses.

"Dormant Commerce Clause"

The Commerce Clause of the U.S. Constitution (Article I, ◊8, Clause 3) forbids discrimination against commerce, which repeatedly has been held to mean that states and localities may not discriminate against the transactions of out-of-state actors in interstate markets even when

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the Congress has not legislated on the subject. The overriding rationale of the commerce clause was to create and foster the development of a common market among the states and to eradicate internal trade barriers. Thus, a state may not enact rules or regulations requiring out-of-state commerce to be conducted according to the enacting state's terms.

Historically, dormant commerce clause analysis has attempted to balance national market principles with federalism, and was never intended to eliminate the states' power to regulate local activity, even though it is incidentally related to interstate commerce. Indeed, if state action also involves an exercise of the state's police power, the impact of the action on interstate commerce is largely ignored. Absent an exercise of a state's police power, the courts evaluate dormant commerce clause claims under a two-tiered approach. If the state has been motivated by a discriminatory purpose, the state bears the burden to show that it is pursuing a legitimate purpose that cannot be achieved with a nondiscriminatory alternative. However, if the state regulates without a discriminatory purpose but with a legitimate purpose, the provision will be upheld unless the burden on interstate commerce is clearly excessive in relation to the benefits that the state derives from the regulation. In essence, a state may regulate transactions that occur within its borders, but not those that occur elsewhere.

"Dormant Commerce Clause" precedent in the eighth circuit

In *Hampton Feedlot, et. al. v. Nixon*, the court upheld against a dormant commerce clause challenge provisions of the Missouri Livestock Marketing Law that the state legislature passed in 1999 preventing livestock packers that purchase livestock in Missouri from discriminating against producers in purchasing livestock except for reasons of quality, transportation costs or special delivery times. The law requires any differential pricing to be published. The trial court held the law to be unconstitutional, but the Eighth Circuit reversed. While the court noted that the Act closely resembled an earlier South Dakota law that had been found unconstitutional, the court noted that noted that the Missouri provision did not eliminate any method of sale – it simply requires price disclosure. More importantly, however, the court noted that the Missouri statute, unlike the South Dakota provision, only regulates the sale of livestock sold in Missouri. As such, the extraterritorial reach that the court found fatal to the South Dakota statute was not present in the Missouri statute. The court reasoned that the statute was indifferent to livestock sales occurring outside Missouri and had no chilling effect on interstate commerce because packers could easily purchase livestock other than in Missouri to avoid the Missouri provision. The court also noted that the Missouri legislature had legitimate reasons for enacting a price discrimination statute, including preservation of the family farm and Missouri's rural economy, and an improvement in the quality of livestock marketed in Missouri. Specifically, the court opined that the Missouri legislature had the authority to determine the course of its farming economy and that the legislation was a constitutional means of doing so.

Hazeltine court's rationale

In a discussion involving the issue of the plaintiffs' standing, the court in *Hazeltine* cited an Ohio statute that charged out-of-state natural gas vendors at a higher sales tax rate than certain in-state vendors. The court reasoned that the South Dakota livestock feeders contracting with out-of-state firms that were not within an exemption under the South Dakota law were similarly disaffected because of the imminent loss of business if Amendment E were to be enforced. However, the court did not discuss the obvious difference between the Ohio statute and Amendment E. The Ohio statute treated out-of-state natural gas vendors differently from in-state vendors. Amendment E treats *all* businesses operating in South Dakota under the same set of rules, regardless of whether the business is a South Dakota business or an out-of-state enterprise. Under the *Hampton* rationale, the test is whether Amendment E has an extraterritorial reach requiring business transactions conducted in states other

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than South Dakota to be governed in accordance with South Dakota law, not whether South Dakota businesses are financially injured because of business relations with companies not coming within an exemption to the law. While the court was addressing legal standing on this point, the court was also framing the dormant commerce clause issue. Unbelievably, the court did not make even a single reference to its prior opinion in *Hampton Feedlot*.

The court also provided no analysis on the issue of what entity is actually performing farming operations under the contract feeding arrangements. If the South Dakota feeding operations are making the relevant production decisions under the contracts and are the ones rendering material participation, then it seems highly unlikely that the out-of-state contracting parties could be found to be engaged in farming in South Dakota in a manner that Amendment E prohibits. The court, again without discussing the matter, simply assumed that Amendment E would apply to the contract feeding situations in the case.

Without any analysis of the actual language of Amendment E, the court determined that South Dakota voters had acted with a discriminatory purpose in enacting Amendment E. The court noted that the record contained a substantial amount of evidence on the point. The court also found relevant on the discrimination issue statements of drafters, as well as a statement of a co-chairman of the Amendment E promotional organization that Amendment E was motivated in part by the environmental problems caused by large-scale hog operations in other states. The court called this statement "blatant" discrimination. The court also found indirect evidence of discrimination in that the drafters and supporters of Amendment E had no evidence that a ban on corporate faming would preserve family farms or protect the environment, and that no economic studies had been undertaken to determine the economic impact of "shutting out corporate entities from farming in South Dakota." Because the court found that Amendment E was enacted with a discriminatory purpose, the state bore the burden to show that it had no other way to advance legitimate state interests. The court held that the state failed to meet its burden.

Implications of the decision

If left standing, the *Hazeltine* court's opinion raises serious concerns about the analysis of future dormant commerce clause cases in the Eighth Circuit, the doctrine of stare decisis, the theory of separation of powers and the ability of states to regulate business conduct within their borders. The court's willingness to ignore it's prior opinion in *Hampton Feedlot* and not evaluate the actual language of Amendment E on a dormant commerce clause grounds poses difficulty for other states defending against either current or future challenges to anti-corporate farming laws. It would appear at this time, however, that the court is not favorably disposed to anti-corporate farming laws in general, and may also strike down other laws designed to deal with the structural conditions presently facing family farming and ranching operations. The court's opinion represents a complete shift from its opinion in *Hampton Feedlot*, and the court appears to have adopted the modern economic theory of free trade as its framework for evaluating commerce clause cases involving state regulation of business activity. Unfortunately, the court failed to note that the types of production contract arrangements involved in the case have been used in other settings to provide vertically integrated firms with market power and to exclude producers from competitive market outlets for their products.

It is hoped that the Eighth Circuit will reconsider its decision in *Hazeltine* and continue the judicial path laid down in *Hampton Feedlot*.

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