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Returns to farmland ownership

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

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.

Both the estimated cash rent rate and the land value are based on USDA surveys. They differ slightly from Iowa State University Surveys.

Results over the entire period

Cash returns - As shown in Table 1, the rate of cash return has been up and down since 1970. Returns dropped to only 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

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Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Corn Price Basis – A2-41 (11 pages)

Soybean Price Basis – A2-42 (11 pages)

Iowa Farmland Rental Rates (1997-2006) – C2-09 (1 page)

Please add these files to your handbook and remove the out-of-date material.

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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. Cash returns have not been adjusted for inflation in the general economy.

Increase (decrease) in value

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

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the plunge in land values during the financial crisis of the late 1980s. The average over the period from 1970 to 2006 was 7.2 percent.

Land value change - The return due to changes in land values was much more volatile, 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 6.4 percent per year.

Total returns - The total return (annual cash return plus change in land value) was 13.6 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.

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
2006	\$130	\$2,930	4.4%	17.7%	22.1%
2005	128	2,490	5.1	13.2	18.3
2004	123	2,200	5.6	7.3	12.9
2003	119	2,050	5.8	3.5	9.3
2002	116	1,980	5.9	4.2	10.1
2001	114	1,900	6.0	4.4	10.4
2000	112	1,820	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 2006 are averages of cropland and pasture rents.

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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—1988-06	7.0	7.3	14.3
Last decade—1997-06	5.8	7.4	13.2
Entire period—1970-06	7.2	6.4	13.6

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.

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

Current period - After 1987, land values and rental rates resumed their upward trend, although at a slower rate than during the boom period. The average rate of return during this period has been similar to the average rate of return over the entire period. In the past few years land values have increased faster than cash rents.

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 36 years later in 2006 was \$2,930, for an increase of 647 percent or 25 percent per year. The average cash return over the period was 23 percent. This was computed by dividing the cash rental rate for each year by the \$392 original purchase price.

End of boom period (1981) - A farmland purchase in 1981 would have been for \$1,941 per acre. The value 25 years later in 2006 was 51 percent higher, for an average increase of 2 percent per year. The average cash return over the period was five percent. The cash return was seven percent in 2006 when cash rents were \$130 per acre.

End of the crisis period (1987) - In 1987 the average Iowa farmland value was \$786 per acre. The value in 2006, 19 years later, was \$2,930 for an increase of 273 percent or 14 percent per year. The average cash return over the period was 13 percent. The cash return in 2006 was 17 percent.

Table 3. Returns to farmland ownership by purchase date

Ownership period	Purchase price	2006 Price	Percent increase in price	Average annual rent as percent of purchase price*
Beginning of boom period to present (1970 – 2006)	\$392	\$2,930	647%	23%
End of boom period to present (1981 – 2006)	1,941	2,930	51	5
End of crisis period to present (1987- 2006)	786	2,930	273	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.



Further guidance on where real property interests constitute an interest in a closely-held business for purposes of I.R.C. § 6166*

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The rules for “15-year” installment payment of federal estate tax require that the value of an “interest in a closely held business” exceeds 35 percent of the adjusted gross estate. The statute specifies that an interest in a closely held business means an interest as a proprietor in a trade or business carried on by a proprietorship, an interest as a partner in a partnership carrying on a trade or business or stock in a corporation carrying on a trade or business. However, there is no statutory guidance on the circumstances in which ownership of real property is deemed to be a trade or business. This has long been a matter of concern in farm and ranch estate (and business) planning because of the almost dominant role played by real estate in farm and ranch operations.

Recently, the Internal Revenue Service provided additional guidance, including a nonexclusive list of factors, to be used in determining whether a decedent’s interest in real property is an interest in an active trade or business so as to constitute an interest in a closely held business for purposes of installment payment of federal estate tax.

Revenue Rulings issued in 1975

In 1975, the Internal Revenue Service issued three revenue rulings in an attempt to provide guidance on the circumstances in which real estate would meet the “trade or business” requirement. Two of the rulings, Rev. Rul. 75-366 and Rev. Rul. 75-367 provided guidance primarily on commercial and residential real property. The other ruling, Rev. Rul. 1975-366 focused on farm real estate.

The recently issued guidance, Rev. Rul. 2006-34, **Reprinted with permission from the August 4, 2006 issue of Agricultural Law Digest, Agricultural Law Press Publications, Eugene, Oregon. Footnotes not included.*

revoked Rev. Rul. 1975-365 and revoked a portion of Rev. Rul. 1975-367. The 2006 ruling did not disturb the farm ruling, Rev. Rul. 1975-366 which involved a share rent lease in which the decedent, the landlord, paid 40 percent of the expenses, received 40 percent of the crops and actively participated in the important management decisions of the farming operation. That ruling, along with subsequent rulings and cases made it clear that cash-rented farm real estate is unlikely to be considered an interest in a trade or business. A 2005 ruling, with non-farm facts, acknowledged that cash rental prior to death precludes eligibility for installment payment of federal estate tax, even as to paying deficiencies, unless the land is used as an integral part of a trade or business in which the decedent was involved.

Over the years, rulings resolved two other issues not made clear in Rev. Rul. 1975-366–

- (1) whether only the decedent could provide the necessary management to meet the trade or business test and
- (2) whether material participation was required for eligibility to be established.

The 2006 ruling

Rev. Rul. 2006-34, states that, to be an interest in a trade or business under I.R.C. § 6166, a decedent must conduct an active trade or business or must hold an interest in a partnership, LLC or corporation that itself carries on an active trade or business. The 2006 ruling goes on to state that, to determine whether a decedent’s interest in real property is an interest in an active trade or business, IRS will consider the following non-exclusive factors –

Guidance on real property interests constitute an interest in closely-held business for purposes of IRC § 6166, continued from page 4

- (1) the amount of time the decedent (or agents or employees, the decedent's partnership, LLC or corporation) devoted to the trade or business;
- (2) whether an office was maintained from which the activities were conducted or coordinated and whether regular office hours were maintained;
- (3) the extent to which the decedent (or employees or agents of the decedent, partnership, LLC or corporation) were actively involved in finding new tenants and negotiating and executing leases;
- (4) the extent to which the decedent (or employees and agents) provided landscaping, grounds care or other services beyond the furnishing of the leased premises;
- (5) the extent to which the decedent (or employees and agents) personally made, arranged for or supervised repairs and maintenance of the property and

(6) the extent to which the decedent (or employees and agents) handled tenant repair requests and complaints).

The 2006 ruling also states that the fact that some of the activities are conducted by third parties such as independent contractors who are neither agents nor employees of the decedent, partnership, LLC or corporation will not prevent the business from qualifying as an active trade or business so long as the third party activities are not of such a nature that the activities are reduced to the level of merely holding investment property.

The fact that the 2006 ruling did not disturb the 1975 farm and ranch guidance and the fact that the five examples in the 2006 ruling all involve non-farm fact situations indicate that the guidance for farm and ranch estates will continue to come, predominantly, from the 1975 farm ruling and the other guidance that has emerged since 1975.

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Decision Tools

The following decision tools have been added to www.extension.iastate.edu/agdm.

Alfalfa or Alfalfa-grass Hay with Oat Companion Crop Budget – Use this *Decision Tool* to project the costs and returns of growing hay with an oat companion crop.

Oat or Other Small Grain Budget – Use this *Decision Tool* to project the costs and returns of growing oats or other small grains.

Alfalfa or Alfalfa-grass Hay Budget – Use this *Decision Tool* to project the costs and returns of growing hay with no companion crop.

6th Annual Iowa Organic Conference

The world market for organic products reached \$25 billion in 2005, with the U.S. portion increasing to \$14.6 billion. The demand for organic crops currently exceeds supply and growers everywhere are encouraged to consider the potential for organic production.

The 6th Annual Iowa Organic Conference will include two new sessions: “How to Transition to Organic Farming” taught by farmers who have successfully made the transition, and the inaugural meeting of the Iowa Organic Association, which, along with the ISU Organic Ag Program, has been established to help transitioning and certified farmers with their educational and marketing needs. In addition, presentations will be available on organic grains, vegetables, herbs, fruits, live-stock and incentives to get you started or enhance your marketing skills.

A trade show of organic products and services will be held during the conference with ample time for visiting. Our all-organic, four-course lunch will include delicious organic products from Iowa and the Midwest. Register today at <http://www.ucs.iastate.edu/mnet/organic06/home.html>! Early bird registration is \$85.

For more information on the Organic Agriculture program at Iowa State University, please see the website at: <http://extension.agron.iastate.edu/organic/>.

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