

Farmland

IN PERSPECTIVE

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GOODWIN

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Nearly 2/3 of USDA budget spent on food assistance programs

The U.S. Department of Agriculture domestic food and nutrition programs account for more than two-thirds of the USDA's annual budget and affect the lives of millions of Americans daily, according to the Economic Research Service of the U.S. Department of Agriculture. Approximately 25% of Americans participate in one or more of the 15 USDA food and nutrition assistance programs at some point during the year. In comparison, approximately 17% of the 2011 USDA budget will go toward farm and commodity programs.

Federal expenditures for USDA's food assistance programs totaled \$78.8 billion in fiscal 2009, a 29% increase over the previous fiscal year and the largest percentage increase in 34 years. Fiscal 2009 marked the ninth consecutive year in which food assistance expenditures exceeded the previous historical record.

The five largest food assistance programs in fiscal 2009 — the Supplemental Nutrition Assistance Program (SNAP), previously known as Food Stamps; the National School

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Farmland investments historically show strong returns, low risk

By Bruce J. Sherrick, Ph.D.

Returns to farmland in the Midwest during the past 20 years have been very strong with relatively low risk. Farmland investments have also offered an excellent hedge against inflation as well as good portfolio diversification benefits.

The past few years in particular have witnessed price increases for farmland in the major corn and soybean producing regions that are relatively high by historical standards. As a result, interest in farmland investments has been renewed among absentee owners, institutional investors, and owner-operators who want to expand their farming operations. Institutional interest in farmland as an asset class has increased dramatically while the interest in land for commercial development and Internal Revenue Service (IRS) 1031 tax-free exchanges has decreased somewhat in the past few years.

During the general equity market "meltdown" of the past two years, questions about farmland acquisitions, how to develop "tradable shares" in agricultural real estate, and other efforts to create meaningful holdings by large long-term money managers have flooded in to my colleagues and me. Many view the ag sector as being relatively unscathed and immune to the revaluation pressures in the mortgage markets and their underlying asset markets.

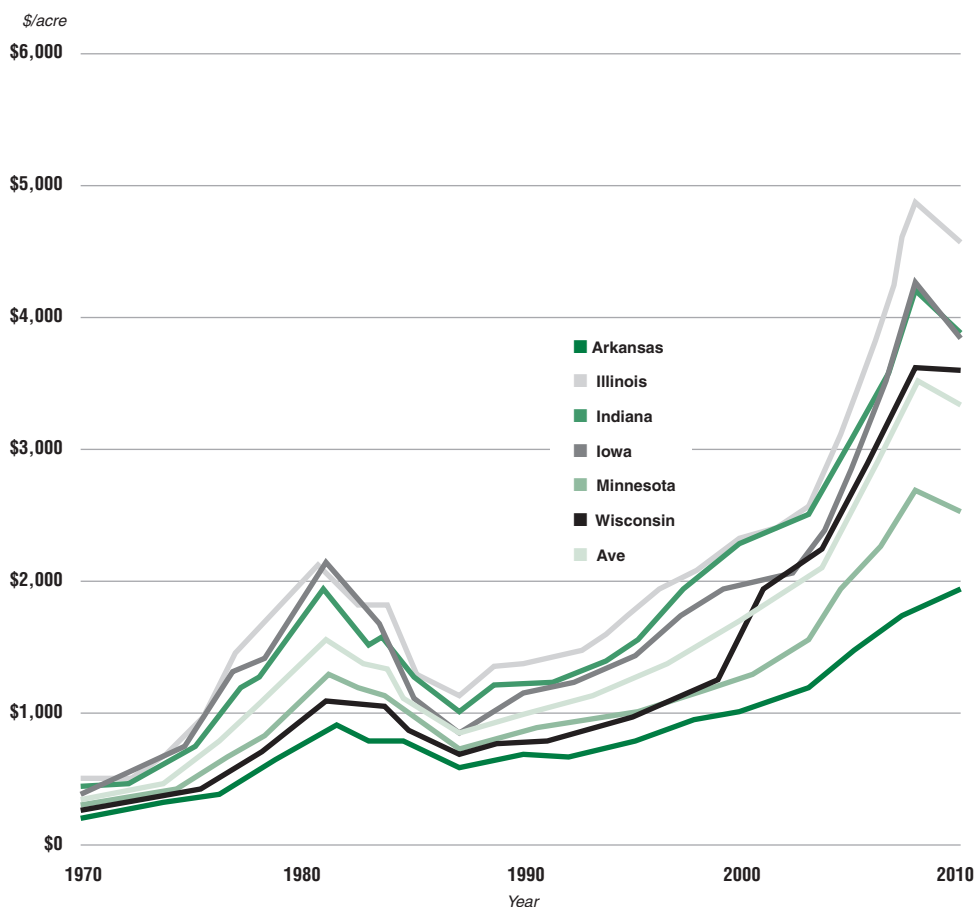
In response, it is useful to consider the performance of farmland investments over time. This includes a historical review of performance and a review of their performance in a more diversified portfolio.

Historical Performance

The graph on the next page provides a historic view of farmland's price pattern and the average rate of capital appreciation from 1970 to the present. These gains for U.S. farmland averaged 5.9% per year in a long and relatively stable pattern while capital appreciation in specific states may vary somewhat. U.S. farmland prices declined only once during the past twenty-plus years, during a period in the early-to-mid 1980s.

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Average value of Midwestern farmland, by state, 1970–2009



The table below shows the average annual capital appreciation rate for each state in the figure on a continuously compounded basis for the same time period.

Capital Appreciation Rate 1970–2009

Arkansas	0.055876
Illinois	0.058468
Indiana	0.059557
Iowa	0.058726
Minnesota	0.063201
Wisconsin	0.072571
Average	0.0614

In addition to this appreciation, current returns to landowners from rent generally have averaged 3–5%, and the total return has been relatively stable compared to alternatives.

Farmland returns compare well to several alternative investments. For farmland in Illinois, for example, see below.

Return on investments in Illinois farmland vs alternative investment options

Asset/Index	Annual average return	Standard deviation	Coefficient of variation	Annual average return	Standard deviation	Coefficient of variation
	1970 – 2009			1990 – 2009		
Illinois Farmland	10.25%	9.73%	0.949	10.40%	4.40%	0.423
S&P 500	6.24%	17.56%	2.817	5.75%	19.28%	3.356
Dow Jones	6.42%	16.30%	2.540	6.66%	16.42%	2.487
Mortgage/REITS	9.00%	30.48%	3.388	10.43%	34.42%	3.300
10 Year Treasury Note	7.30%	2.54%	0.348	5.58%	1.39%	0.250
Consumer Price Index (CPI)	4.36%	2.88%	0.661	2.69%	1.12%	0.415
Producer Price Index (PPI)	3.98%	5.01%	1.259	2.27%	4.01%	1.763

Bruce J. Sherrick is Professor of Agricultural and Applied Finance, Center for Farm and Rural Business Finance, University of Illinois. The Center conducts a comprehensive research and outreach program targeted to farm and rural businesses and their capital providers.

Sherrick teaches graduate courses, has appeared frequently on lists of teachers ranked as excellent and has received outstanding teaching awards. Sherrick conducts academic research and helped create www.farmdoc.illinois.edu, the award-winning, agricultural-decision making support program online at the University of Illinois.

Portfolio effects

Given the relatively low variability of returns and the lack of correlation with traditional equity investments, the portfolio diversification effects of farmland investments have also been very attractive. The returns on corn and soybean farmland showed a low or negative correlation with traditional equity investments during the last two decades while maintaining a positive correlation with inflation and the Producer Price Index (PPI). While the time period being considered affects the magnitude of the results, the general story is the same for virtually any historic period. In comparison, the Dow and the S&P series have about a .96 correlation with each other and approximately -.20 on average with inflation as measured by the Consumer Price Index (CPI). In the vernacular of portfolio selection, the asset class demonstrates exceptional risk efficiency — in essence providing high return per unit of risk it contributes to a well diversified portfolio.

Acquiring and managing farmland does require greater expertise than most other financial assets. And, as always, one must be careful when interpreting the past as a projection of the future. Yet as an asset class, the return on investment for farmland has been remarkable in both the return on capital appreciation and current income, and in measures of stability. The recent financial crisis has perhaps only made it easier to observe the unique relative performance of farmland to other investments. Overall, and by virtually any measure sensible to consider, investments in farmland have performed well whether viewed by themselves or as a part of a package of investments and should be considered when evaluating any mixed-asset investment set.

For a discussion of how the data used for analysis was compiled, please email sherrick@illinois.edu.



Comparison of Farm Profiles in Midwest States

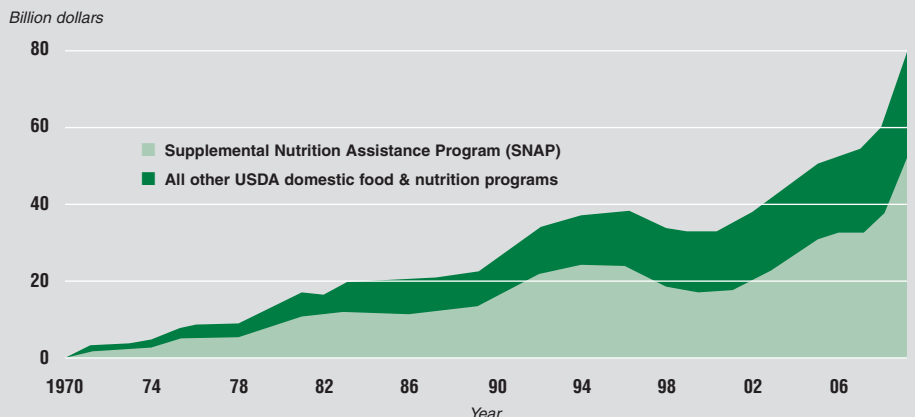
State	% total farm acres in state farmed by tenants or renters	Average farm size (acres)	Farmland as a % of total land area	% farming as principal occupation	Top agricultural commodities (1-3)	Operator age, average
Arkansas	45.9%	281	41.7%	44.5%	Broilers Rice Soybeans	56.5
Illinois	61.6%	374	76.8%	64.1%	Corn Soybeans Hogs	56.2
Indiana	54.3%	242	64.4%	41.9%	Corn Soybeans Hogs	55.0
Iowa	52.6%	331	86.0%	52.4%	Corn Soybeans Hogs	56.1
Minnesota	42.4%	332	52.9%	48.9%	Corn Soybeans Hogs	55.3
Missouri	33.9%	269	66.0%	41.8%	Soybeans Corn Cattle & Calves	57.1
Nebraska	43.7%	953	92.5%	60.5%	Cattle & Calves Corn Soybeans	55.9
Wisconsin	29.6%	194	43.8%	47.2%	Dairy Corn Cattle & Calves	55.0

Based on 2007 Census of Agriculture, NASS, USDA

USDA Budget *cont. from page 1*

Lunch Program; the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC); the Child and Adult Care Food Program; and the School Breakfast Program — accounted for 95% of USDA's food assistance expenditures of \$78.8 billion.

USDA expenditures for food assistance, FY 1970–2009



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