

What Makes Farm Value

The value of a farm depends mainly on what it will produce. Back of production is soil, climate, fertilizer and other productivity factors. In terms of soil and climate, Iowa has been fortunate, being blessed with fertile soil and a reasonably good climate for crop production.

A comparison of Iowa's soil productivity with that of other states is provided by a preliminary classification of all land into five grades made by the National Resources Board and published in their report for 1934. Iowa ranked at the top of the 48 states with one-fourth of all the Grade 1 or best land in the country. The list of the top six states in Grade 1 land, which follows, shows that all six states are located in a solid block in the Corn Belt and that Iowa is far in the lead:

| State | Millions of Acres | Per Cent |
|-----------|-------------------|--------------|
| Iowa | 26.0 | 25.7% |
| Illinois | 14.8 | 14.6 |
| Minnesota | 12.0 | 11.9 |
| Missouri | 8.7 | 8.7 |
| Nebraska | 8.1 | 8.0 |
| Indiana | 5.2 | 5.2 |
| Other | 25.2 | 25.9 |
| Total | <u>100.0</u> | <u>100.0</u> |

Production, of course, is not the only factor which makes value. There are intangible factors like location, type of road, community, and the like, but year in and year out the crucial question in valuing a farm is what it will produce, and what will it give the owner in net income.

The best way to measure net income to farm land and buildings is to figure what the return in dollars per acre is to a landlord who rents the farm out on terms common to the area. Owner-operator income is more difficult to measure than landlord income because of numerous owner-operator income and expense items which are not related to land value. Livestock returns can vary tremendously depending on the owner's ability and losses from disease, factors which generally do not influence landlord income.

The relationship between net income and value has been a helpful one down through the years. In one sense this expresses the difference between the right to the net return in one year and the right to the net return for all years in the future which is farm ownership.

An easy way to state the income-value relation is with an example. A farm with an average net return of \$5 an acre a year is valued at \$100 an acre. In this case the relationship of income to value is 1 to 20, or in percentage terms the net income is five per cent of the value. What is important is that the owner is getting a return of

five per cent on an investment of \$100 an acre.

The relationship or rate of return on farms in Iowa has been far from constant over the years. Some wide swings in percentage return are shown by the following Iowa figures:

| | <i>Per Acre Returns</i> | | |
|------|-------------------------|------------|--------------------|
| | Value | Net Income | Percentage or Rate |
| 1920 | \$255 | \$7.60 | 3% |
| 1941 | 88 | 4.45 | 5 |
| 1966 | 331 | 14.90 | 4½ |

What is particularly important in these figures is the low rate of return received by owners in 1920 at the top of the land boom. This brings out the highly speculative level of farm values during the boom period when buyers bid up the price of farms to a point where they were only getting three per cent return on their land investment. At this same time the current rate on farm mortgages in Iowa was 6 per cent. What buyers were betting on was increased income and increased values in the future. In short, they expected farm values to continue going up in the future as in the past.

In 1941 and 1966, on the other hand, the return received by an owner of a farm bought in each of these years was much higher. Since farm mortgage interest rates were higher in 1966 (6 per cent) than in 1941 (4½ per cent), it is clear that more people anticipated an increase in value in 1966 than in 1941. In 1941 the country had

just come through 20 years of declining or low values, while in 1966 it had just come through 26 years in which values rose in all but four years.

The 1966 buyer was counting, to some extent, on net income going up in the years ahead which in turn would cause farm values to go up. This same buyer hoped that he would have the same experience in the next ten years as the 1956 buyer who bought at \$220 an acre a farm that was worth \$331 an acre in 1966. The latter buyer would have a clear gain of \$111 an acre if he sold his farm in 1966. Also with present yields and cropping practices he would be making around \$15 an acre net return compared to \$11 back in 1956.

Looking ahead, therefore, expectations of future values should be based on an estimation of what net income will be in the future. This will depend on crop yields, cropping practices, product prices, farm expenses, and farm size in acres. Second, the current rate of return should be noted—figuring the percentage return on the price paid for a farm today. Comparing this rate of return with present and estimated future interest rates we can see to what extent buyers are counting on future increases in net incomes to justify and support present values.

In 1967 the future for net income looks good, much better than in the 1950's. To be sure expenses are going up, but so are yields and the size of a farm which a farmer can operate efficiently.

On net income we can conclude that if improvements in technology continue as in recent years and the demand for farm products continues to show strength, it is likely that these two factors will outweigh the downward pressure of increased farm expenses.

On the rate of return the situation is one that bears watching. We are, it is true, far above the three per cent return of 1920, but the purchaser today must pay a higher rate on his mortgage than he is receiving on his land investment—6 per cent versus $4\frac{1}{2}$ per cent.

The most favorable factor of all in the present land market is the absence of speculation. Buyers today, in most cases, are buying farm land to operate or to keep as an investment, not buying, as in 1920, to hold for a short time and to sell at a profit. The emphasis now is mainly on rate of return and not on gain from buying and selling. Mortgage lenders and bankers are insisting, in the main, on sound financing practices.

Farm land values in 1967 at their highest point in history certainly provide no bargain. On the other hand, for the capable operator of an efficient-sized farm, they are reasonably well supported by present net income and the future outlook for farm product prices.