

THE BOTTOM LINE

Purchasing farmland—Is there ever a good time?

By Todd King, CPA
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The last few months have taught us that we are living in unprecedented times. Six months ago, we could not have imagined all of these changes and the decisions we are making. For various reasons, some farm landowners are contemplating the sale of their land. They may have a family member who has been financially affected by the coronavirus. They may realize that if they leave the farm to the heirs, it will be splintered into very small ownership interests. Or, there is also the concern that leaving the farm to the children will be a burden to them as they do not understand the farming business. For whatever reasons, the potential availability of neighboring farms up for sale can present an opportunity for the farmer wishing to expand.

Land—a good investment?

Traveling across the state, presenting to farmers, I often discuss the

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	Loan Amount	Interest Rate	Payments	Payment Amount Per Year
Loan #1	\$1,000,000	8%	20	\$101,852
Loan #2	\$1,000,000	4%	20	\$73,582
Difference				\$28,270
Years of loan				x20
Difference over life of loan				\$565,400

purchase of farmland. As a conservative CPA, the audience is usually cautioned about excess debt load and the potential implications of this. The other common point is that land will rarely, if ever “pay for itself.” While many factors impact this broad statement, I do believe it to be true. The farmer will usually need to subsidize the purchase of land with income from another source. Most often, this comes from income derived from land that is already owned.

So, if farmland will not pay for itself, does that mean it is not a good investment? No. Let me illustrate with a simple analogy. Stocks such as Microsoft, Apple and Google have been viewed as suitable investments. Investors purchasing these stocks do not expect the dividend to pay for the stock. It is the dividend, along with the appreciation in the value of the stock, which makes it a good investment.

Likewise, in looking at farmland, it is the annual net income from the land, along with the appreciation, that makes the investment appealing. One must keep in mind that “appreciation in value” of land will not make mortgage payments unless you sell the land. The takeaway is that the farmland may be a good investment, but don’t plan on it paying for itself without being subsidized from other sources. The key is making sure that the demand for a subsidy does not exceed the availability of different sources. In simple terms, most farm operations can only afford so much debt.

High-priced land

Twenty-five years ago, I built a new house. At that time, it seemed like a lot of money, and I could not imagine that I would ever view it as a good investment. Today, that same house would likely cost four times what it did back in 1995, and I am feeling much better about my investment. Likewise, the cost of farm ground will often look overpriced at the time of purchase. The key is to be able to survive the lean years while paying for it, so you can later look back and see it as an inexpensive and very worthwhile purchase.

Interest rates

Interest rates on long-term money are currently quite low. Most people do not understand the significant impact that interest rates may have on long term purchases. The chart above contrasts the difference between an 8 percent loan

and a 4 percent loan, given a \$1,000,000 loan and a 20-year amortization.

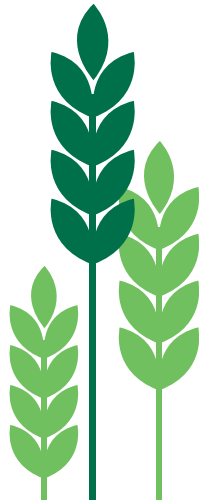
The bottom line in comparing a 4 percent interest rate with an 8 percent rate is that over the life of the loan, total payments will be \$565,400 less with a 4 percent rate! Today's interest rates go a long way in making farmland affordable, and these rates will not likely last. Entering into a long-term land purchase should be done with a long-term fixed interest rate. Anyone who was around to see what happened in the early '80s realizes that variable interest rates can be detrimental.

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Conclusion

For various reasons, we are seeing some farmland shake loose and sell. As expected, most of it appears overpriced. Today's interest rates assist in making the purchase work, but in almost all cases, it will need to be subsidized from other sources. For those looking to continue their operation into the next generation, the purchase of land can almost be a necessity. The key is to avoid buying too much, too fast. Farm operations can only take on so much debt. Finding a comfortable balance between taking on new land while managing the debt load will ensure your operation is around for the next generation. ■

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