SPECIAL REPORT

A Publication of Flanagan Realty, LLC

November 2008

Is Farm Land a Better Investment Than the Stock Market?

By Dan Flanagan

The Dow Jones Industrial average has now dropped over 40% from its peak just a little over one year ago, to levels last seen in 1997. That means that over a decade's worth of gains have now been lost. Residential real estate values in Illinois have now dropped over 20% from their peak, and recent predictions are that they will drop another 10% before the end of 2009. Commercial real estate values are also plunging, with buyers unwilling to pay the astronomical prices that were all too common over the past few years. Oil is now down by over half from its peak, and many other commodities are following suit.

In the midst of this financial turmoil, as we watch a major recession unfold and people see their retirement savings dwindle by as much as half, good quality Illinois farmland has continued to appreciate at a rapid pace and all indications so far are that values are continuing to hold steady. The August 2008 Agricultural Newsletter from the Federal Reserve Bank of Chicago noted that farmland throughout the entire Seventh Federal Reserve District appreciated over 15% on average over the past year, and good quality farm land in Illinois appreciated at 17% during the same timeframe.

Those returns certainly sound enticing given the recent results in the stock market. But, would investors who have now seen dramatic losses in the stock market have been better off investing in Midwest farmland instead of stocks? Is farmland a safe haven for your hard earned money - even in the middle of the worst financial crisis in decades? Would investing even a portion of your savings in farm land have had a positive effect on your returns over the past few years?

A quick comparison of the relative returns of stocks versus agricultural land provides some support for the idea that investing in farm land may be healthy for your portfolio.

I compared historical prices for the Dow Jones Industrial Average with information on historical farm land prices in Illinois for excellent productivity crop land. By my calculation, since 1998 the value of an acre of Illinois farmland appreciated an average of 9% per year. During the same time frame, the Dow Jones Industrial Average, based on the November 3, 2008 closing price of 8424, appreciated a meager 0.6%. So, not including dividends or cash rents, and assuming that the money was invested on January 2, 1998 and not withdrawn, farmland beat stocks by a considerable margin.

Using the same methodology over the past 20 years, the Dow Jones Average has returned an annualized average of 16% per year while farmland has returned an average of about 11.7% per year, again not including dividends or cash rents. This is a very basic analysis, and does not give any consideration to other factors that could influence the end result, such as taxes or other costs associated with holding the investment.

Others have undertaken more rigorous studies comparing the results of stocks and farmland. In all of the studies I reviewed total returns for stocks and farm land were reasonably close. Whether stocks or farm land won depended largely on the timing of the investment, and how certain variables were considered such as dividends, reinvestment of proceeds, farm rental income, and taxes.

In a July 2007 paper entitled "*Comparing the Stock Market and Iowa Land Values: A Question of Timing*" Michael Duffy of Iowa State University provides a more thorough analysis of the relative results of an investment in stocks vs. farm land, concluding that the timing of the investment can have a significant impact on which asset class has a better return. Duffy's calculations span a 50 year time frame and conclude that the average year over year percentage change for farm land is 5.5% with average income of 5.7%, for an 11.2% overall annual return, while stocks (based on the Dow Jones Industrial Average) had an average year over year return of 8.7% with an average dividend of 3.7%, for a 12.4% overall annual return.

However, the question of whether farmland's overall return is greater than stocks may not be the only question to consider when evaluating the merits of adding farmland to a diversified portfolio. It is quite clear from a number of studies that farmland can provide substantial benefits as part of a larger portfolio with a long term horizon.

In a 1982 paper presented at the American Agricultural Economics Association Annual Meeting, Enrique Hennings, Bruce J. Sherrick and Peter J. Barry of the University of Illinois at Urbana-Champaign presented a paper entitled "Portfolio Diversification Using Farmland Investments." One of their key conclusions was as follows:

> One of the main advantages of farmland is that it behaves differently from traditional stock indices and bond markets, providing a natural protection tool against market volatility. Furthermore, farmland returns are negatively correlated with stocks and bonds and positively correlated with inflation and therefore it may be used by investors to reduce risk in times of higher inflation…. Farmland investments, as measured by both cash returns and NCREIF indices, exhibit higher returns and lower standard deviation than most of stocks or bonds.

Duffy indicates in his analysis that the standard deviation of land values over the 50 year study period was only 11.2% vs. a standard deviation of 16% for stocks, meaning that land had far less volatility in value from year to year when compared to stocks. Moreover, the fact that farmland is negatively correlated with other asset classes means it usually performs well during times when stocks and bonds are not, a fact that recent evidence seems to support.

This reason alone is why many large portfolio managers are adding land to their mix of investments. The Mormon Church for many years has been one of the largest holders of agricultural land with holdings approaching $5 billion in value. TIAA-CREF, the largest U.S. manager of retirement funds, bought $340 million of farmland in seven states in December 2007, and interest from other large portfolio managers continues to grow.

Will farmland returns remain strong in the coming years? Is it safe to buy now, or is farm land headed for a crash like so many other asset classes? Are there fundamental reasons why farm land will continue to perform well?

Although a continuation of the exceptionally strong recent returns of the past few years may not be likely, there are strong fundamental reasons why the long term trend in farmland prices should continue to be upward.

As Mark Twain once said about land, they aren't making any more of it. Unlike houses, shopping centers, office buildings, or other real estate, it is nearly impossible to create new farmland, meaning you don't have to worry about overbuilding. In fact, while demand continues to grow, supply continues to shrink. The United States loses about one million acres of farmland per year, and this rate has increased 51 percent from the rate reported in the previous decade. All of that is land that can never be replaced, and by converting it to other uses the overall supply of land available for agricultural production is permanently reduced.

At the same time, the world's population continues to grow resulting in increasing demand for agricultural products. The growing affluence in countries such as China and India are leading to changes in diet as well as growth in overall food demand, which largely benefits U.S. farmers. Alternative energy, especially ethanol, is another factor that continues to push the demand for U.S. crops, and agricultural land, upward.

In addition to the all of the above, there are a couple of other reasons why farmland makes a great investment when compared to stocks.

Land can be easily understood and its value is transparent and easily determined. If you want to know the value of a parcel of farmland, stroll down to the local coffee shop in any farm town on almost any morning and ask around. Chances are you will get an honest and accurate answer without too much effort. It is also easy to verify your estimate of value with a quick check of public records. You do not need to rely on annual reports or financial statements with pages full of legal disclaimers and footnotes that may or may not represent reality. For the most part, what you see is what you get.

There is another reason why many people like land better than stocks. With all of the uncertainty, lack of disclosure, excessive risk taking, poor accountability, and other shenanigans that seem to dominate the financial markets these days, holding a transparent, easily understood, and tangible asset such as land helps them sleep better at night.

For many, that factor by itself trumps all of the other arguments.

Flanagan Realty, LLC is a real estate brokerage and advisory company focusing on land-related issues. Dan Flanagan, the founding principal and managing broker, has extensive experience in land acquisition and disposition, market analysis and strategy, entitlements, and financial analysis for farmers, land investors and developers, home builders, lenders, and property owners. Our experience and capabilities include residential, farms, commercial and industrial land, as well as special use land sites such as Brownfields, quarries, and power and gas facilities. If you are seeking to acquire or sell land, or are facing other land-related problems, we can help transform your challenges into opportunities.

For more information about our services or available properties, please contact us by telephone at (630) 388-8522, or by email at flanaganrealty@yahoo.com.

We also visit invite you to visit our website at www.flanaganland.com

Flanagan Realty

Licensed Real Estate Broker in Illinois

"Transforming Challenges into Opportunities"

FLANAGAN REALTY, LLC
36W739 RED HAW LANE
ST. CHARLES, IL 60174