Profitability vs. Feasibility and the Paradox of Purchasing Farmland

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do not have available cash during the first two or so years before that first calf is sold, you will not be able to make loan payments or meet the necessary operating costs before returns start rolling in. Thus, the project may be financially infeasible even though it may be profitable.

The Paradox of Purchasing Farmland

While owning farmland can be a very profitable venture over the long-term, farmland will typically never cash flow when purchased with substantial borrowed capital. The reason has to do with the non-depreciable and capital gains nature of farmland.

Land is competitively priced in the economy. If land is providing a greater return on investment than other assets, more people will want to purchase land which will drive the price of land upward (and the rate of return downward) until the rate of return on land is equal with other investment opportunities (and vice versa). Given that land is non-depreciable, or in other words, the salvage value of land is 100%, a lower annual rate of return is required to make land a profitable investment compared to a building, tractor, or livestock which will normally depreciate or lose value over its useful life.

Land also generally appreciates over time and returns a capital gain to the owner upon being sold. This characteristic also contributes to land not needing a large annual return to be a profitable investment in the long-run.

The relatively short life of loans used to acquire land compared to land’s infinite life makes it very difficult for land to cash flow. The buyer must either have a large down payment and/or an alternative source of cash flow to make the principal and interest payments on the land over the terms most often required by lenders. This is especially problematic for beginning farmers given the increase in land prices associated with the recent boom in commodity prices (see figure).

Many associate the inability of land to pay for itself as simply a farm income problem. But as discussed, as farm income increases and is capitalized into the price of farmland, the cash flow problem for those desiring to purchase land still exists. Someone lucky enough


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