Feb 7 [illegible]

"Ag-Land Fund" Review and Assessment

Review of Proposal

A detailed description of the plan was obtained from the bank and the securities firm who are developing it. Staff members in these companies—the Continental Illinois National Bank and Trust Company of Chicago, and the brokerage firm of Merrill Lynch, Pierce, Fenner and Smith, Inc.—have been very helpful in providing descriptive materials and in answering questions. The current status of the planned fund is as follows: Clearances have been obtained from the Securities and Exchange Commission and the Comptroller of the Currency; the Internal Revenue Service has not yet verified the tax status of the fund, but its approval is expected and the plan is expected to be operational before the end of February.

In the planned initial offering, $50 million in shares in the fund will be available for purchase by specified investor groups. Funds obtained from the sale of shares are to be invested in "working farms" in up to 15 midwestern and southern states. The farms are to be of good land quality, with up to 3/4 of the acreage in Class I or II land as classified by the Soil Conservation Service. The farms are to be managed by the bank in its role as trustee, and will be leased to farm operators.

The major goal of the fund is stated to be capital appreciation rather than current income, and typical investors will be required to continue their investments for a minimum of 5 years. The secondary goal of the fund is an annual net return of 3 to 5 percent after paying the trustee a quarterly management fee of 1/4 of 1 percent of the value of the managed assets.

Shares in the fund can be purchased only by "employees' stock bonus, pension, or profit-sharing trusts." Shares (participating interests in the Ag-Land Fund) sold only to this group can be sold without the usual registration requirements of the Securities Exchange Act of 1934 and other related acts. Also this targeted group is not required to pay income taxes on earnings or capital gains. Such taxes are collected only when money from the pension or profit-sharing trusts is distributed as earnings to the pensioners or other members of the trust group. Because of this tax characteristic of the potential investors, the Ag-Land Fund itself (and the trustee of the fund) will presumably not be required to pay income taxes on fund earnings. This question has been presented to the Internal Revenue Service and a ruling is anticipated shortly.

Merrill Lynch, Pierce, Fenner and Smith Incorporated (the "Agent") will solicit original participants in the fund. For its services, the Agent will be paid a fee of approximately 3.8 percent of the amount contributed by original participants to the fund. The fund is to be divided into units with an original "beneficial interest value" of twenty-five thousand dollars ($25,000.00). A participant must purchase at least $100,000.00 of these, and can purchase no more originally than $5,000,000.00.[1] Except under unusual circumstances, withdrawals from the fund are not permitted until five years have elapsed since the purchase, and then only with a one year prior notice.

In considering prospective investors (the pension funds), it should be noted they have become very large. At the end of 1975 private pension fund asset

---

[1] If the total subscriptions are less than $15,000,000.00 as of the final offering date...then the fund may not become operative, as determined by the trustee.

values exceeded $216 billion in total. Total private plus state and local government funds exceeded $320 billion.

?

One of the reasons for the establishment of the fund as stated by an employee of the bank was: "This fund will give the trustees of pension and profit sharing trusts a vehicle for further diversification of their portfolios. The Employee Retirement Income Security Act of 1974 places a great deal of emphasis on portfolio diversification. Thousands of workers, through their vested interests in the participating pension and profit sharing trusts, will be able to own a piece of American agriculture."

wrong to assume prices always go up

Evaluation of the Fund

The establishment of such a fund appears to hold several implications for the farm real estate market and for the ownership of farm real estate. These include: additional pressure on land values, concentration of farm real estate in the hands of investment trusts and reduced availability of land for individual ownership.

up or down

To the extent that new funds for farmland purchase are added to the market by these funds there will be added upward pressure on land prices. The relative amount of pressure on land values would depend on the number, size and concentration of land purchases and on the intensity of bidding for properties. The proposed $50,000,000 Ag-Land Fund appears insignificant when compared to the $12.2 billion spent on farm real estate transfers Nationally during the year ending March 1, 1976. However, for this issue it is improper to consider the farmland market on a National scale. Farmland markets are very segmented, with each local community being composed of one or more. In any and every locality concerned, an additional bidder would result in higher land prices.

The trustees of the funds are to be guided, in part, by values placed on properties by qualified appraisers. If the goal of a 3 to 5 percent annual return after paying the management fee is to have any likelihood of being achieved, the trustees will necessarily need to be very skillful purchasers. Competition for farmland has been very strong for a number of years. Operating farmers seeking to enlarge their operations have been the primary buyer and they have acquired nearly 60 percent of all tracts transferred for farming purposes. Frequently these operators have only one opportunity in a lifetime to acquire land that fits well with theirs as a farm unit and they often pay more for the property than other prospective buyers just to achieve the goal of enlarging their operation.

Costs

In discussing the question of impact on land value, there is a need to consider both the real and the psychological impact, although it is doubtful whether the two can actually be separated and weighed.

The volume of farmland expected to be purchased under the initial fund offering appears to be small--$50 million would permit buying 50,000 acres if the average price were $1,000 an acre, less if the price were greater. Nationwide 20 to 30 million acres of farmland (2 percent or so of the total) are transferred in ownership each year, at values in excess of $12 billion. However, our farmland markets are very segmented.

Psychologically the activity with its attendant widespread publicity has doubtless already had an impact on the opinions of potential buyers and sellers of farmland about what the farmland is "worth". This impact may actually increase as the activity gets off the ground. Speculative influences in the market are probably worsening. The important question is whether this effect will moderate or disappear if the fund activity proceeds in a slow and rational way. There are several safeguards written into the plan that are designed to restrain speculative appetities, a major one being the prohibition against quick withdrawal or re-entry.

The continuation of the family farm structure in the nation depends partly on the continual entry of young people into the farming profession. This subject has been one of much concern. Recent information on this subject is favorable. In the 1970 to 1975 period, the number of young persons (ages 16—34) self employed in agriculture actually increased about one-third, rising by about 93,000.

To the extent this fund or others become important in the farm economy, it would appear that opportunities for young people to enter and succeed in farming will worsen. The decline in the number of farms and the accompanying rise in farm sizes has happened very rapidly in recent years, and this land fund activity would have a tendency to hasten this movement. Undoubtedly strictly economic motives would guide the managers of the fund in their selection of tenants to rent the land that is purchased. Some part of this land would have been purchased from other landlords, most typically from retired farmers or from farmers who would retire soon and become landlords. The fund managers would necessarily screen their potential tenants more closely than the other landlords would, and there would be a stronger tendency to favor the well-equipped, most proven farm operator. It would thus become a little harder for new persons to enter farming than before, and make them even more dependent on family or governmental assistance.

If the fund is successfully established and proves to be economically operational, something that has yet to be proved, their example will be followed by other brokerage and banking groups and a small beginning of $50 million could become multiplied into a rather major force in the land market.

The proposed fund raises a major philosophical question concerning the goals of the American people with respect to the structure of the farming sector. Should large bank trustee organizations become asset holders and landlords for our most vital resource? Or, should we continue to pursue the goals of individual ownership and control that have been fostered since the beginning of this nation? Are there any social or economic goals that would be better served under such an arrangement? It seems unlikely that there are or that such goals would outweigh the goal of protecting the freedom of choice of individuals. However, such questions cannot be addressed on purely economic grounds, but must be viewed from a perspective that considers the longer run implication for the welfare of our system.

If the fund is indeed exempt from payment of taxes, it achieves a substantial benefit in terms of investment opportunities relative to individuals whose current income is taxed annually and, therefore, have a reduced volume of funds to invest. In an inflationary economy, deferring taxes means that those taxes, when paid, are paid with dollars that have a lower purchasing power and are therefore less valuable than those paid out of current income. Such tax benefits collected under the control of a highly sophisticated investment organization are more powerful than if they were distributed to individuals.

These points can be demonstrated by an example comparing "A" with "B" where they both make $40,000 a year and are in a 40 percent tax bracket on the basis of combined State and Federal taxes. However, "A" can participate in a profit-sharing plan and B cannot.

This is a very simplified example but indicates the general impact of such a program.

(1) "A" is a corporate employee. He puts the maximum of 25 percent of his salary, or $10,000, into the Fund. This amount is not subject to tax.

"B" is a sole proprietor. He also would set aside $10,000 for the purchase of farmland, but his original $10,000 is taxed at 40 percent, leaving him $6,000.

(2) Assume both "A" and "B" receive an 8 percent rate of return from the cash flow generated from a farm purchase. A's return is not subject to tax while it goes into the Fund and becomes entirely available for expansion. B's return is, again, subject to the 40 percent tax, making his effective return 4.8 percent.

(3) "A" has a rate of return of 8 percent on $10,000 "B" has a rate of return of 4.8 percent on $6,000.

When the investment and earnings are compounded over a period of years the impact is dramatic.

Assume when "A" and "B" retire that they are in a 20 percent tax bracket.

Years	A Before taxes	A After taxes	B After taxes
10	$21,588	$ 17,270	$ 9,588
20	46,608	37,286	15,323
30	100,625	80,500	24,489

The benefits attributable to the deferral of taxes are obvious.

(4) If the example is expanded to the case of the $50,000,000 Ag-Land Fund, the figures become:

Years	A Before taxes	B After taxes	A > B Multiple
10	$ 86,350,000	$ 47,940,000	1.80
20	186,430,000	76,615,000	2.43
30	402,500,000	122,445,000	3.29

These figures do not account for investment tax credits and depreciation related to the property.

The potential of such a program is indicated by the magnitude of the sum of money in pension and profit-sharing funds shown in the attached table. These funds are, and traditionally have been, largely invested in the stock market and Government securities. Although Government policy favors the creation of pension funds to help prepare society's members for retirement, the effects of using the funds for investment in farmland are very different from investment in the stock market and Government securities. Investment of these funds in American farmland would be in direct competition with the American farmer.

While such a fund or group of funds would appear to have adverse effects on the land market and on the opportunity of individuals to own land they would have little or no impact on the tax base of a rural community or on the revenue it receives because the fund would be required to pay real estate taxes on its holdings. It can only be assumed that, in its operations as a landlord for farm tenants or for operators who owned some land and wanted to rent more, the fund management would act responsibly and would not manage the farms to the detriment of the rural community in which its assets were located.

In terms of government farm program payments, such payments would be either received by the tenant or by the funds depending on the individual's rental agreement.

In reviewing the proposed fund, no aspects were found that would appear to offer any substantial advantage to rural America, to farm operators, or society in total. In addition, the possible increase in diversity of portfolio to pension funds would seem to have a minor impact on the viability or performance of such funds. On balance, the potential negative aspects of such funds in terms of their impact in land values and the opportunity for individuals to acquire land appear to outway any conceivable gains in stability of earnings to pension funds.

-Table-

ASSETS OF ALL PRIVATE AND PUBLIC PENSION FUNDS

Book Value, End of Year (December 31, 1975)

(Billions of Dollars)

	1968	1969	1970	1971	1972	1973	1974	1975
Private	118.1	128.5	138.2	152.8	169.8	182.6	194.5	216.9
Insured pension reserves 1/	35.0	37.9	41.2	46.4	52.3	56.1	60.8	71.7
(Separate accounts included above) 2/	2.2	3.5	4.9	7.1	9.8	9.6	8.9	12.5
Noninsured pension funds 3/	83.1	90.6	97.0	106.4	117.5	126.5	133.7	145.2
Public	98.6	111.1	123.7	135.5	148.3	164.8	173.1	192.1
State and local government	46.3	51.8	58.1	64.4	72.2	85.1	89.0	106.0
U.S. Government								
Federal Old-Age and Survivors Insurance	25.7	30.1	32.5	33.8	35.3	36.5	37.8	37.0
Federal Disability Insurance	3.0	4.1	5.6	6.6	7.5	7.9	8.1	7.4
Civil Service Retirement and Disability Program 4/	19.4	20.8	23.1	26.4	29.2	31.5	34.6	38.6
Railroad Retirement	4.2	4.3	4.4	4.3	4.1	3.8	3.6	3.1
Total Private and Public	216.7	239.6	261.9	288.3	318.1	347.4	367.6	409.0

1/ Statement value.
2/ Separate accounts of life insurance companies, established for specific pension plans, allow greater investment latitude than is permissible under state laws for general life insurance assets.
3/ Includes deferred profit sharing funds and pension funds of corporations, unions, multi-employer groups, and nonprofit organizations.
4/ Includes Foreign Service Retirement and Disability Trust Fund.

(End of Text)

-0-

Published by THE BUREAU OF NATIONAL AFFAIRS, INC., WASHINGTON, D.C. 20037