

Financial Analysis of Farmland Owned by the Departments of Corrections and Human Services

ISSUE

This **Issue Review** provides information concerning farmland owned by the Departments of Corrections and Human Services, present value of the land, and alternative investment strategies for that value.

AFFECTED AGENCIES

Department of Corrections (DOC)
Department of Human Services (DHS)

CODE AUTHORITY

Iowa Code sections [904.302](#) and [904.706](#) (farmland owned by the DOC and DHS)

BACKGROUND

Historically, the State Institutions (prisons and DHS residential facilities) operated farms to offset operating costs. The farms provided food and generated work for the Institutions' residents. The General Assembly eliminated the Department of Social Services by dividing it into the Department of Corrections and the Department of Human Services in 1983. The responsibility for managing the farms was given to the newly created DOC in cooperation with the DHS.¹

This **Issue Review** focuses on farmland owned by the DOC and the DHS, and managed by Iowa Prison Industries (IPI) through an agreement between the two Departments under Iowa Code chapter [28D](#).² These properties are maintained by the IPI.

[Senate File 447](#) (FY 2014 Justice System Appropriations Act) specifies that it is the intent of the General Assembly that the DOC continue farm operations at the same or greater level as was in existence on January 1, 2011. This language has been included in the Act for several years. The DOC is prohibited from renting land under its control that was not being rented on January 1, 2011, without legislative approval. The DOC is required to provide meaningful job opportunities for inmates employed on the farms.

Iowa Code section [904.302](#) creates the Farm Operations Administrator and defines the duties of the position. Iowa Code section [904.706](#) creates the Revolving Farm Fund to provide a funding

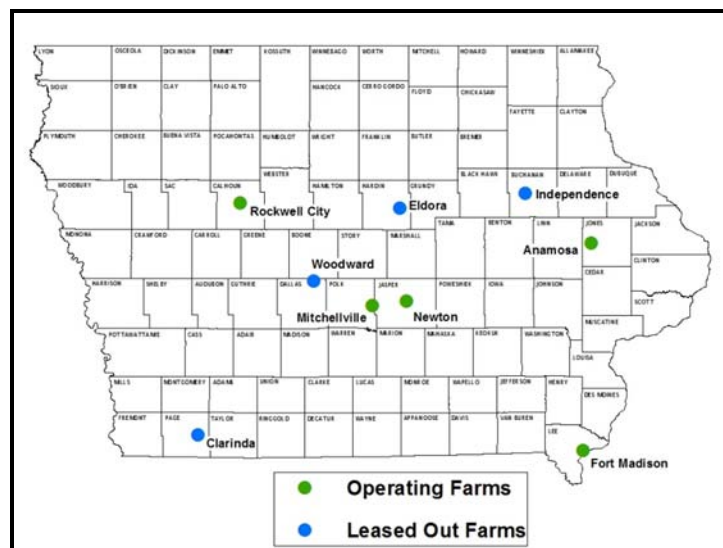
¹ SF 464 established the Department of Corrections in 1983. See the 1983 Iowa Acts, [Chapter 96](#).

² The Departments of Corrections, Human Services, Natural Resources, Transportation, Public Defense, and the Board of Regents are authorized to buy and sell real estate as necessary to complete the mission of the agencies. A variety of state agencies own land; this asset is reported in the [Iowa Comprehensive Annual Financial Report for FY 2012](#).

mechanism for farm operations. This section requires annual financial reporting to be on a calendar year (CY) basis. This section also requires the Governor, the chairpersons, and ranking members of the House and Senate Appropriations Committees plus the chairs and ranking members of the Justice System Appropriations Subcommittee to be notified before any farm operation is phased out. Iowa Code section [904.317](#) permits the Director to buy and sell real estate, and sets the parameters of any acquisition or sale of real estate.

CURRENT SITUATION

Iowa Prison Industries manages 10 farms listed in **Attachment 1**, including four farms owned by the DHS. The farms are managed by the IPI and maintained on a cash-based accounting system. Farm operations include row crops, cattle, and rent on approximately 5,000 acres. The map below shows the farm locations across the State.



Profits and losses generated by the farms flow through the Revolving Farm Fund. All income generated from renting out the DHS farms is deposited in the Revolving Farm Fund. Iowa Prison Industries does not receive a state appropriation to operate the farms; they must generate a net profit to remain in business.

Farm Administration

There is a Farm Operations Administrator plus four full-time and four part-time staff. Total staffing is equivalent to 6.69 FTE positions. Staff uses the Iowa State University (ISU) [Iowa Farmland Value Survey](#) definitions to determine the amount of acres by category (crop ground or pasture/timber/grass). The crop ground is certified to meet those definitions by IPI farm staff with the county Farm Service Agency (FSA) where the farm is located. Leased crop ground is certified by the renters.

The IPI modified its land rental practices in 2012 to use a more competitive bid practice. Bids are taken every three years. The rented farms are bid on a staggered schedule and are not all rebid in the same year. The leased ground is advertised in local newspapers for each farm location. Bid packages are sent to past bidders and any new interested bidders. The bid package states the minimum acceptable rent per acre to ensure IPI receives comparable rent for crop ground as other farmers in that county. The current [ISU Cash Rental Survey](#) is used to show the average, high, medium, and low cash rental amounts for each county to determine the minimum acceptable rent per acre. Bidders are required to provide financial statements, years

of farming experience, a list of their equipment, references, and a letter of credit from their banker each year. This information is reviewed and reference checks may be conducted. The top five bidders that meet qualifications and the current renter (if interested) are then invited to an auction. The lease is awarded to the highest bidder that shows financial soundness, farming experience, and equipment to farm the ground, good references, and a letter of credit from their banker. The price per acre is fixed for three years.

The IPI first started using the new process in 2012 for crop year 2013 at the Eldora farm, and it resulted in a substantial increase in rent receipts, from \$313.00 per acre for 2012 to \$410.00 per acre for 2013, a 30.9% increase in rent per acre. The IPI intends to auction the leased ground at Woodward and Independence in 2013.

In addition to private farmers, the IPI rents to other state agencies or private nonprofit corporations. The Clarinda Youth Corporation (CYC) rents 20 acres for its program for at-risk and delinquent juveniles. The Animal Rescue League (ARL) rents 10 acres at Rockwell City for rescued horses. The Iowa Correctional Institution for Women (ICIW) also entered into a venture with ISU for planting trees on one acre. The Department of Natural Resources (DNR) rents 50 acres: 47 acres at Fort Madison (state nursery seedlings), one acre at Mitchellville (wildflowers), and two acres at Rockwell City (wildflowers and prairie grasses).³ The table below shows the rent income and lease expiration by location.

IPI Rent Receipts and Lease Expiration by Location

Location	CY 2009	CY 2010	CY 2011	CY 2012	FY 2012		Other Entity	Lease Expiration*
					Private Farmer	Rent Per Acre		
Eldora	\$ 40,564	\$ 40,564	\$ 64,587	\$ 69,142	\$ 313.00	\$ 0		February 2016
Fort Madison	25,399	10,561	18,350	24,084	211.05	199.00	DNR	February 2016
Glenwood**	30,885	0	0	0	0			
Independence	12,144	12,144	21,222	23,037	315.58			February 2016
Newton	122,341	122,341	234,207	253,938	317.00			February 2016
Clarinda	2,780	2,780	3,130	3,200	125.00	110.00	CYC	February 2016 CYC same as the farmer
Rockwell City	1,635	1,635	2,215	2,215		199.50	ARL	2027
Woodward	106,972	106,298	210,373	228,572	352.30	110.00	DNR	2021
Total	\$342,720	\$296,323	\$554,084	\$604,188				2017

Notes:
 *Leases are in the process of being modified.
 **The General Assembly transferred the Glenwood farm from IPI and the DHS to the DNR for archeological preservation during the 2009 Legislative Session.

The IPI has sent lease cancellation notices to the farmers at Woodward and Independence so that rent auctions can be conducted. Leases will be for three years rather than the current five years. The successful bidder will enter into a three-year lease starting in March 2014 and ending in February 2017. The IPI intends to send lease cancellation notices to the farmers at Fort Madison and Newton so that rent auctions can be conducted, and leases will be for three years rather than five years. The successful bidder will enter into a three-year lease starting in March 2015 and ending in February 2018.

Iowa Code section [904.302\(8\)](#) requires the IPI to pay property taxes on rented farm ground, starting in CY 2007. The property taxes paid by the IPI by calendar year include:

- 2007 – \$21,022 (half-year only)
- 2008 – \$44,098
- 2009 – \$43,244
- 2010 – \$49,062
- 2011 – \$45,325
- 2012 – \$45,277

³ Iowa Code section [904.705](#) permits the DOC to operate forestry nurseries in cooperation with the DNR.

Inmate Labor

Inmate labor on a prison farm provides an option for the DOC to meet Iowa's Hard Labor Law (Iowa Code section [904.701](#)). The table below shows inmate labor hours worked on the prison farms for the last four years. The IPI pays the allowances for offenders working within the farms training programs via the Revolving Farm Fund. The beginning allowance for all offenders working on the farms is \$0.58 per hour; that is the established allowance per DOC policy. Allowances may increase over time as offenders undertake more skilled work training, work longer in the program, or meet other work-related criteria. Since most offenders working on the farms are short tenured and mostly manual labor, the majority earn \$0.58 per hour.

Inmate Hours Worked by Calendar Year and Location

Location	CY 2009	CY 2010	CY 2011	CY 2012
Fort Madison	4,265.0	3,334.0	5,397.0	12,440.0
Anamosa	5,186.0	4,795.0	4,569.0	5,071.0
Newton	3,343.0	2,803.5	4,840.0	3,687.0
Total	12,794.0	10,932.5	14,806.0	21,198.0

The use of inmate labor increased by 130.5% at Fort Madison from CY 2011 to CY 2012. The increase is primarily due to creating a truck garden (approximately nine acres) at Farm Three. Work at the ISU nursery increased at Fort Madison when the DNR rented five more acres. Inmate labor at Anamosa and Newton remained relatively stable.

Generally, offenders need to be a low security risk to be eligible to work on a prison farm, and low-risk offenders are more likely to be released to parole supervision. Therefore, there is high turnover in inmate labor on prison farms.

Analysis of Balance Sheets and Income Statements

Refer to **Attachments 2** and **3** for balance sheets and income statements for CY 2007 through CY 2012. Net income for the farm operation has varied widely over the last six years, ranging from a low of \$8,304 in losses in CY 2009 to a high of \$521,947 in profits in CY 2012. The average annual net income across the last six years was \$208,827. Three years ago, the average annual net income over a six-year reporting period (CY 2004 through CY 2009) was \$92,595. This is an increase of 125.5% in average annual income in three years.

The increase in net income for the IPI farms is similar to that experienced by other Iowa farmers. According to the U.S. Department of Agriculture (USDA) Economic Research Service, Iowa net farm income was \$95,200 for CY 2012; this is an increase of 84.9% compared to three years ago, and an increase of 181.1% compared to six years ago. Farm income is up primarily due to the increased value of corn and soybeans, cattle, and rent.

The price per bushel of soybeans was \$14.30 in Market Year (MY) 2012; this is an increase of 50.2% compared to MY 2009. The price per bushel of corn was \$7.20 in MY 2012; this is an increase of 100.5% compared to MY 2009.⁴ Beef cattle prices have been trending up over the last three years. For example, average prices were \$122.70 (live weight) for choice steers in CY 2012. This is an increase of \$48.5% compared to CY 2009.⁵

Iowa Prison Industries has reinvested recent profits in buildings, machinery, equipment, and inventory, resulting in asset growth. Values for current assets such as cash on hand, accounts

⁴ See the USDA Economic Research Service website at www.ers.usda.gov/ for historical commodity prices. See the Legislative Service Agency's [Factbook](#) for more farm statistics.

⁵ Historical prices are provided by the ISU Extension and Outreach website at www.extension.iastate.edu/agdm. See the Iowa Beef Center website at <http://www.iowabeefcenter.org/> for information on cattle ranching, prices, and forecasts.

receivable, crops in process, feed, livestock inventory, and fixed assets like farm buildings, machinery and equipment, and breeding stock have all increased.

While farm prices are up, the IPI still relies on rent income for long term stability and working capital. The IPI, like other state agencies, cannot have short-term working capital loans.⁶ Approximately 38.5% of the farmland is rented to private farmers, the CYC, the ARL, and the DNR.

PRESENT VALUE AND ALTERNATIVE INVESTMENT STRATEGIES

There are many variables to consider regarding state ownership of land. See the *Issue Review*, [Proposed Sale of State Farm Ground](#) published by the LSA on December 2, 2010, for issues to consider when reviewing the farm ground operation.

One example of the tradeoffs of maintaining the prison farms is the truck garden at Fort Madison. Creating a truck garden significantly increased inmate hours worked. It also provided fresh fruit and vegetables to the Iowa State Penitentiary at Fort Madison at a reduced price. The IPI sold the produce to the prison at 50.0% of the price of the current vendor. However, establishing and maintaining the garden is subsidized by the IPI rental income. The garden cannot financially sustain itself, especially if the produce continues to be sold at 50.0% of the market rate. It generated about \$8,000 in sales in CY 2012. Also, the Fort Madison prison food budget is \$1.4 million in FY 2013. While this budget includes more than fresh produce, substantial savings for the prison will not be realized through purchases from the truck garden.

Calculation of Present Value of Farm Ground that May Be Sold

Attachment 1 shows 4,933 acres of farm ground under the control of the DOC and the DHS. Based on the following adjustments, the net acres identified for potential sale is 3,869.

- Subtracted 200 acres of pasture at Anamosa to provide a buffer zone around the prison and land for potential future construction.
- Subtracted 237 acres to exclude any ground at Farm One at Fort Madison from the calculations. This farm is dedicated to construction of the new maximum security prison.
- Subtracted 97 acres to exclude any ground at Mitchellville from the calculations. The farm is dedicated to construction of new prison buildings, and also, the DOC, the IPI, and ISU are working on current and proposed future landscape architecture projects at this location.
- Subtracted 200 acres of pasture at Newton for a buffer zone.
- Subtracted 50 acres from crop ground at Rockwell City for a buffer zone.
- Subtracted 20 acres at Clarinda for the athletic field currently rented by the Clarinda Youth Corporation.
- Subtracted 200 acres at Woodward for a buffer zone.
- Subtracted 50 acres currently rented by the DNR for the state nursery and 10 acres rented by the ARL due to the long-term lease arrangements currently in place with those two entities.
- No land under the control of the DNR, such as Glenwood land, is included in the acreage amount.

Several calculations were conducted to capture price variations across time. The first calculation is based on the [ISU 2012 Iowa Farmland Value Survey](#). This survey provides values for high, medium, low, and average value cropland by region and average value by county in 2012. The calculation applied the medium price to the number of good quality acres, adjusting for the average price by region and county versus region. For the lower quality acres, the low

⁶ Iowa governmental agencies are not allowed to incur debt pursuant to the [Iowa Constitution, Article VII](#), sections 2, 5, and 24.

region value was applied, also adjusting that low value for the ratio of county average to the region average for all acres. The value of other acres (pasture and timber) is calculated at the nontillable pasture rate from the survey. A 9.0% reduction was applied to the end result of the calculation to capture the error rate associated with the farmland value survey.⁷ The first calculation results in a gross sales estimate of \$21.6 million.

The second calculation is based on the [ISU Farmland Value Survey for September 2013](#). This survey provides values for high, medium, low and average value cropland by region for crop ground, pasture, and timber in September 2013. The calculation applied the medium price to the number of good quality acres, with no adjustment for the average price by region or county versus region. Pasture and timber values were calculated using the same methodology as the first calculation, and a 9.0% reduction was applied to the end result. The second calculation results in a gross sales estimate of \$22.2 million.

The third calculation is based on the statewide average value per acre for farmland for September 2013. The average price per acre for crop ground is \$8,780 and for nontillable pasture rate is \$2,702. A 9.0% reduction was applied to the end result. The third calculation results in a gross sales estimate of \$22.0 million. See **Attachment 4** for the calculation details.

Selling 3,869 acres currently owed by the DOC and the DHS may generate approximately \$21.9 million in gross receipts, that is, receipts before the costs of the sale, including but not limited to realtor commissions, survey costs, advertising, and legal and administrative costs incurred by the Office of the Attorney General and the Department of Administrative Services. This estimate is based on current information and estimated acres available for sale, plus the average of the three calculation methodologies. Actual gross receipts may vary due to fluctuations in farmland and residential real estate markets, plus the results of any land surveys. Additionally, the Iowa farmland price per acre has increased over 250.0% since 2003. Concern has been expressed that farm ground prices may be in a “speculative bubble.”⁸

The calculations above may be understated inasmuch as the value of other assets, such as machinery and equipment, are not included. It is assumed those assets will be sold if the land is sold. The receipts from such sales may be used to cash flow the costs of selling the land. On the other hand, the calculations above may be overstated given the high land values in the State. If current prices are in a “speculative bubble” the price per acre may decrease by the time the land is actually sold.

Alternative Investment Strategies

The IPI farms are a long term, tangible asset. Any such asset may be subject to appreciation or depreciation over time. The IPI farms have significantly appreciated in value over the last several years. See the *Issue Review*, [Proposed Sale of State Farm Ground](#), published by the LSA on December 2, 2010. The land's value was calculated to be \$13.6 million at that time, using the [2009 Iowa Land Value Survey](#). As calculated above, the land's value is currently estimated to be \$21.9 million, an increase of \$8.3 million (61.0%) over the last three years. The IPI net farm income has increased as well over the last three years, going from \$33,894 in CY 2010 to \$521,947 in CY 2012, an increase of \$488,053 (1,439.9%). The calculation of an annual rate of return on the land results in a gain of 2.38% (net income of \$521,000 divided by land value of \$21.9 million). The calculation of a rate of return using a four year smoothing method results in a gain of 1.2% (net income over the last four years of \$1.0 million divided by

⁷ The survey is based on the opinion of individuals knowledgeable in the value of Iowa farmland. It is not based on actual sales. See <http://www.extension.iastate.edu/agdm/wholefarm/html/c2-70.html> for further discussion of the survey and its historical accuracy.

⁸ See the [ISU 2012 Iowa Farmland Value Survey](#) for a thorough discussion of the factors, both positive and negative, that are driving Iowa farmland prices.

land value of \$21.9 million divided by four years). This percentage results in a dollar value rate of return of \$262,800.

Actuarial valuation reports have recently been published for certain retirement systems; these systems invest in assets over the long term and are used here to illustrate the potential use of the \$21.9 million land value.⁹ The table below shows the actuarial rate of return for the Judicial Retirement System, the Municipal Fire and Police Retirement System of Iowa (411 System), the Peace Officers' Retirement, Accident, and Disability System (POR), the Iowa Public Employee Retirement System (IPERS), the Revolving Farm Fund, and the annual rate of return for the investment pool managed by the Treasurer of State.¹⁰ These rates are then applied to the \$21.9 million estimated value of the land to show potential income for alternative investments.

Rate of Return and Potential Income for Investing \$21.9 Million

Fund	Smoothing Period	Rate of Return	Potential Income for Investing \$21.9 million
Judicial Retirement System	four years	7.90%	\$ 1,730,100
411 System	five years	4.02%	880,000
POR	four years	4.30%	941,700
IPERS	four years	7.57%	1,657,000
Revolving Farm Fund - annual	annual	2.38%	521,000
Revolving Farm Fund - annual	four years	1.20%	262,800
Pooled Investment Fund	annual	0.27%	59,000

BUDGET IMPACT

As discussed in this Issue Review, Iowa farmland values are at historically high levels. The General Assembly may want to consider selling the land while it may be at a peak in value. Any sale of farmland will result in one-time revenue to the State of approximately \$21.9 million in gross receipts. The costs of the sale may be expensed against the Revolving Farm Fund. Any sales of land will likely occur over the course of several fiscal years, possibly beginning in CY 2015 and ending in CY 2017. Refer to the *Issue Review*, [Proposed Sale of State Farm Ground](#) published by the LSA on December 2, 2010, for a list of assumptions related to selling the land and available mechanisms for cash-flowing the sale.

The alternative investment strategies presented in this *Issue Review* do not capture the opportunity costs associated with selling the land, or the future value of maintaining ownership of the land. For example, during the 2008 Legislative Session, the General Assembly authorized the construction of a new maximum-security prison at Farm One at Fort Madison, and expansion of the Iowa Correctional Institution for Women at Mitchellville. Both construction projects were built on existing land owned by the State. This lowered the overall costs of the construction projects. Selling the farmland reduces the amount of land available for potential future expansion or replacement of existing DOC and DHS facilities.

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⁹ Copies of the actuarial valuation reports from the Judicial Retirement System, the 411 System, the POR System, and the IPERS are available by contacting the LSA.

¹⁰ Note the investment pool has different goals compared to retirement funds, including but not limited to security, liquidity, and yield that dampens its rate of return. See **Attachment 5** for information from the Iowa Treasurer of State regarding percentage yields of various short-term investments.