Spotlight
US Farmland

Right product, right place
US agriculture offers opportunities for investment performance
Foreword
UNLOCKING THE FULL POTENTIAL

Agriculture is a complex and globalised industry where investment is usually medium to long term. We have focused our analysis on the regions where we believe the best opportunities are currently. We classify the best opportunities according to productive enterprise and focus in on the top performing productive assets available in the US for that particular enterprise. The US farmland market is multifaceted in terms of enterprise size, soil type, water availability, ownership structure and varying foreign investment policy on a state-by-state basis. This report identifies the constraint on investment performance and illustrates the ‘real’ opportunities available, which can be tailored to the needs of both private and institutional investors via a range of investment vehicles. For example, the private investor whose criteria is based on commodity production and has the ability to acquire scale, with the potential for growth through further aggregation during the term of investment, may concentrate their search in the Corn Belt. Whereas those looking for more specialist cropping ring fenced opportunities might be drawn to the lower reaches of the Mississippi or the productive permanent crops of California. There are many challenges and obstacles to overcome in order to unlock the full potential of US ‘land capital’, but with the right knowledge and strategy, farmland investors have the ability to acquire assets of significant value and potential. We hope that this Spotlight proves of interest and, if so, that you will contact us if you would like to explore opportunities further.

EXECUTIVE SUMMARY

With a land area of 1.7bn acres, US farmland offers a rich diversity of agricultural output. See pages 4/5.

There is a wide variation in profitability across different crop types in US farming. See pages 6/7.

Average farmland values are strongly correlated with commodity price movements. See pages 8/9.

Understanding policy on overseas ownership is key to successful investment in US farmland. See pages 14/15.

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This publication was published in May 2015. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document.

Glossary
USDA: United States Department of Agriculture
NCREIF: National Council of Real Estate Investment Fiduciaries
IPD: Investment Property Databank

US data often uses bushels rather than tonnes. These are crop specific as examples for key crops in table below:
- Wheat: 36.8 bushels per tonne
- Corn: 39.4 bushels per tonne
- Soybeans: 36.7 bushels per tonne

Fallow (see Graph 1) - Includes land in cover and soil-improvement crops and cropland on which no crops were planted. Some cropland is idle each year for various physical and economic reasons. Acreage diverted from crops to soil-conserving uses (if not eligible for and used as cropland pasture) under Federal farm programs is included. Cropland enrolled in the Federal Conservation Reserve Program (CRP) and Wetlands Reserve Program (WRP) is also included.

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With agricultural land accounting for nearly three-quarters of the US's total land area, it offers a rich diversity in agricultural use.

**THE SIZE OF US AGRICULTURE**

The total land area of the US is around 2.3 billion acres (9.2 million sq km) (almost 40 times larger than the United Kingdom). Of this, 1.7 billion acres are used for agriculture (arable, forestry, permanent crops, permanent pastureland). The agricultural land accounts for 74% of the total area of land in the US, which is a similar proportion to that in the UK. Forestry covers almost 40% of the agricultural area. Graph 1 shows US agricultural land use. The geographic spread of farm production across the US is shown on Map 1. As would be expected, these regions do not follow state boundaries, although there are concentrations of farming types within the states. 24% of the agricultural area is used for crops of which corn (maize for grain), soybeans and wheat are most significant, accounting for 21%, 19% and 11% respectively of the total cropland. Corn is the most widely produced feed grain in the US, with most of the crop providing the main energy ingredient in livestock feed. Com is also processed into a wide range of food and industrial products including fuel ethanol. Over 60% of total cropland is located in three areas, namely Heartland, Northern Great Plains and Prairie Gateway (Map 1).

The grassland is grazed by 9.3 million dairy cows plus followers with an average herd size of just over 115 cows, although the majority (74%) of US dairy farms have less than 100 cows. Farms with more than 100 cows produce 85% of the milk. US milk production is concentrated in the Northern Crescent and in California. The beef industry is substantial with 95 million breeding beef cattle plus followers. However, almost half of these cows are concentrated in herds of over 1,000 head. Although cattle are widespread (Map 1), beef production is mainly in Texas, Iowa, California, Florida, Nebraska and Kansas. The USA sheep flock is very small with just 5.5 million breeding sheep compared with 15.8 million in the UK.

**Productive agriculture**

Although soil quality varies across the USA, and is reflected in farmland values (see page 8), the continent does have some of the most fertile soils for cropping in the world. Land is classified into ‘Land Capability Classes’ which rate land from one to eight on agronomic factors which include landscape, slope, depth and texture of soil. Under good management, Classes 1 to 4 are able to support the main field crops including grass without a reduction in the soil’s long term productivity. Classes 5 to 8 have limited use for commercial farming and are mainly pasture, range and forestland. These do often provide environmental and leisure opportunities. The US generally has favourable climates for productive agriculture and water availability is good. This is either from natural sources or large scale irrigation systems. However, future water security is high on the policy agenda to ensure the long term growth of the agricultural industry. Managing climate change risk has become the most pertinent issue for worldwide agriculture in recent decades and has encouraged research and development into better management and implementation of technology to mitigate climatic risk. The US is at the forefront of government research into agriculture and a privatised industry dedicated to research and development: this helps provide more streamlined results and motivation to continue improving efficiency across agricultural markets.

In many respects, the agricultural sector in the US is unique with market characteristics that are not typical or as pronounced as some other major developed world exporters. For example, 60% of the total value of US agricultural production comes from just three regions which are very output specific with highly intensified production. These are the Heartland, the Fruitful Rim and the Northern Crescent.
Market dynamics

WEATHERING THE ECONOMIC CLIMATE

There is a wide variation of profitability across different crop types in US farming.

“A major drought in 2012 caused a significant spike in corn and soybean prices”
Ian Bailey, Savills Rural Research

GRAPH 2
Average US crop margins

GRAPH 3
Corn enterprises factors across the key regions (average 2009 to 2013)

GRAPH 4
Proportion of US subsidies by key programs

SPECIALIST CROPS

Some key facts

- High value crops include rice, cotton, tree nuts (such as almonds, macadamia and pistachio), orchards, soft and citrus fruit, vegetables and grapes.
- These crops tend to be intensively cropped and regionally located (see map on page 5). For example California, according to USDA statistics, was the leading fresh market for vegetables and melons in 2014 producing 80% of the total US value of these crops.
- The abundance of water, including for irrigation, in the Mississippi Delta creates the opportunity for intensive field cropping. Key crops are cotton and rice but the agronomic conditions are ideal for a variety of high value crops.
- High value crop production is a viable alternative to commodity cash crops but it often requires: increased management and marketing skills, higher capital and labour input, dedicated storage and distribution facilities – the output is often perishable – specialist markets and an increased presence along the supply chain.
- As with any investment decision, deciding between commodity cash cropping and more intensive high value farming operations is all to do with managing the risk and return profile.

Of the main ‘cash grain’ crops, corn and soybean are more profitable than wheat.

Specialty crops offer higher rewards but with significantly higher production costs.
Farmland markets

**VARIATION IN FARMLAND VALUES**

Average farmland values in the US are strongly correlated with commodity price movements

Farmland values are highly dependent on land and soil type, productive capacity and access to markets and hence vary significantly between states (see Map 3) and locations within states. Average farmland values are strongly correlated with commodity price movements (Graph 5), although there is often a time lag and land values are minimally affected by short term fluctuations and shocks to commodity prices.

In the US, values, in contrast to the UK, are generally not influenced by demand from non-farmer or ‘lifestyle’ buyers except in areas close to population centres. The effect of the diverse demand profile for UK farmland compared with other countries where values are much more closely correlated to farm output and commodity prices is significant. The graph shows farmland values in domestic currency to eliminate any exchange rate effect.

Since 1950, average values across the US have recorded an annualised increase of 6.6% with an increased rate of growth during the past 10 years, despite a correction in 2009, of 8.1%. The corresponding figures for UK farmland are 7.5% and 13.7%.

These figures reflect the increased presence of non-farming/investor buyers competing with the farmer buyers, which has ensured steady growth over the past decade without any pause. In the US, farmers represent three quarters of the amount of farmland sold every year in the US. However, anecdotal evidence suggests that market activity has historically been very thin, with some estimates indicating that only around half of one percent of US farmland is sold each year.

As in the UK, studies suggest that farmland sales generally only occur due to death or retirement rather than as a result of affordability levels. In 2012 USDA reported that many farming families rely on holding land for a retirement fund. In addition, the report noted that relatively little farmland is sold each year due to death or retirement rather than as a result of affordability levels.

Average farmland values across the US are now almost $3,000 per acre with average cropland at just over $4,000 per acre and pastureland at $1,300 per acre. Values are closely correlated with the productive output, with the highest average cropland values in the Corn Belt at $7,200 per acre with Iowa recording $8,750 per acre. The wide variation in average values between states is illustrated on Map 2. The average hides a wide range of values and driving crop yield productivity gives long term gains in asset performance.

There is little data available on the amount of farmland sold every year in the US. However, anecdotal evidence suggests that market activity has historically been very thin, with some estimates indicating that only around half of one percent of US farmland is sold each year.

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**GRAPH 5**

**US farmland correlated with commodity prices**

- Average farmland ($/US per acre)
- Average farmland at 2014 prices ($/US per acre)
- Corn ($/US/tonne) RHS
- Soyabeans ($/US/tonne) RHS
- Wheat ($/US/tonne) RHS

**GRAPH 6**

**US farmland values more closely aligned with farm output**

Average farmland values across the US are now almost $3,000 per acre

Highest average cropland values in the Corn Belt stand at $7,000 per acre
Income yields LEASING VS OWNER OPERATED

Farming the land in hand will give an income yield premium, while leasing mitigates climate and price volatility risk.

In the long term leasing has the advantage of a higher income yield over owner operated farming. Income yields in the US are regionally driven by market conditions and climatic factors with the Corn Belt and Delta Lake regions having a higher income yield than other areas of the USA (except the UK, where non-leasing farmers are more common). Within the Corn Belt, 60% of the land is leased to another operator – usually of three to five years in order to avoid declining rental yields and to maximise income potential. The length of leases in the US are shorter leasehold periods when compared to the UK, farm leases at market levels to avoid declining rental yields and to maximise income potential. This mirrors the trend in the UK.

Income yields are 2% in the southern plains and typically 3% in the northern plains. The risk of price volatility and market conditions leading to a lower income yield means that a risk mitigation strategy is required. However, with the states of Illinois, Indiana and Ohio present the best opportunities. The states of Illinois, Indiana and Ohio present the best opportunities. The region has seen significant capital growth in land values over the past twenty years, which is illustrated in the trend in the UK. With a 15-year average annual capital growth rate increasing crop yield has been a key driver in the long term. However, recent performance of the past five years has included the 2012 drought yield of 139 bushels per acre. The past five years has included the 2012 drought yield of 139 bushels per acre.

The region has seen significant capital growth in land values over the past twenty years, which is illustrated in the trend in the UK. With a 15-year average annual capital growth rate increasing crop yield has been a key driver in the long term. However, recent performance of the past five years has included the 2012 drought yield of 139 bushels per acre. The past five years has included the 2012 drought yield of 139 bushels per acre.
Ownership

A QUESTION OF OWNERSHIP

Ownership is key to successful investment in US agricultural land. The most prevalent issue is the overseas buyer looking to acquire agricultural land in the US, a knowledge and understanding of the restrictions and policy on foreign ownership is crucial. In addition, the interest in overseas ownership of agricultural land increases, the rules can and do change. Lobbying from local communities or a new government policy can lead to a change in the regulations relating to purchasing and impact on the exit strategy of any investment. This is very unlikely in the US. Indeed, there is very little to no political risk in terms of investment in the US. The most prevalent issue for investment into farmland here is title rights but the risk is reduced by the ability to purchase title insurance upon purchase of land.

The US has more than adequate access to country credit, policy transparency, tax taxation and loan accessibility. However, US fiscal policy is state-based and some states have better fiscal policies than others. Farmland has always been a relatively illiquid asset when compared to commercial or residential property markets. As in the UK, the US agricultural and farmland markets are generally highly accessible and transparent with good access to trade organisations and market information. Currently relatively little US farmland is held in direct overseas ownership and, in 2012, this accounted for just 1.15% of all farmland across the US. The largest proportion of overseas ownership is concentrated in Maine. Table 1 shows the proportion of farmland in each state under overseas ownership.

In contrast to the UK where there are no restrictions on Foreign Direct Investment (FDI), there are some states and provinces in the US where overseas ownership is restricted. US subsidies are not available to overseas individuals and entities. In addition, the Agricultural Foreign Investment Disclosure Act requires the disclosure to the Secretary of Agriculture of foreign ownership in farmland purchased by overseas buyers in the United States. These restrictions should not deter investors who wish to purchase farmland in the US. There are opportunities in the key agricultural regions for both the private and institutional investor.

Relatively little US farmland is held in direct overseas ownership

Iain Bailey, Savills Research

Farmland has always been a relatively illiquid asset when compared to commercial or residential property markets. As in the UK, the US agricultural and farmland markets are generally highly accessible and transparent with good access to trade organisations and market information. Currently relatively little US farmland is held in direct overseas ownership and, in 2012, this accounted for just 1.15% of all farmland across the US. The largest proportion of overseas ownership is concentrated in Maine. Table 1 shows the proportion of farmland in each state under overseas ownership.

<table>
<thead>
<tr>
<th>State</th>
<th>% of FDI</th>
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<td>0.04%</td>
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Source: USDA and Savills Research

Planning Ahead

What you need to know

An investment in the US requires consideration of UK and US taxation and reporting obligations. Investing in the US might seem potentially perilous, with its patchwork of federal, state and local tax and regulatory regimes that can vary widely in scope and effect. But this minefield can be successfully navigated with a bit of advance planning. Investment in US farmland can be efficiently structured to preserve the UK tax advantages of investment in farmland while allowing investors access to the US market.

Like the UK, the US imposes an estate tax on persons holding US assets at death. This tax applies to US assets with a value in excess of a mere $600,000 threshold, at a rate of 40%. Some US states also impose their own state level estate tax, though at much lower rates (with a typical maximum of 16%). Unlike the UK, there is no relief for business or agricultural property.

Therefore, a key consideration for UK domiciliaries investing in US farmland will be to structure their investment to restrict taxes on death to those payable in the UK and US. The most attractive method is to invest via a corporate structure, which can block the attribution of estate tax to any particular person. Alternative ownership structures include trusts or partnership, which are commonly used in the US, but may not be as tax-efficient to the general investor.

Care also needs to be taken when considering the US income tax (which also applies to capital gains) implications of an investment. Investments through non-corporate entities (that is, investments by individuals and by trusts) are taxed at a maximum federal rate of 39.6% for ‘ordinary’ income (which includes business operating income) and 20% for so-called long-term capital gain.

Investments by corporate entities are subject to a maximum 35% tax rate at the corporate level (with no preferential tax rate for long-term capital gain), plus potentially an additional 30% tax at the shareholder level. There may also be state level income tax.

However, UK investors are particularly well placed to make investments in the US through corporate entities because the UK has both a favourable income tax treaty and a favourable estate and gift tax treaty with the US. These treaties can reduce the 30% shareholder level tax to as low as 5% and can block imposition of US estate tax. Credit can also be given for the US tax suffered against any UK liability.

As an added attraction, hold over relief on the reinvestment of the sales proceeds of UK farmland can apply to purchases of US farmland, as there is no geographical restriction to this relief.

Words: Bertie Hodges-Abrahall, Withersworldwide
US farmland continues to outperform other investments, such as residential property and retail.

Farmland has outperformed other US real estate assets over the past 15 years as illustrated in Graph 9. The National Council of Real Estate Investment Fiduciaries (NCREIF) Farmland Index showed a total return of 13% for agricultural properties bought as investments over the past 15 years with the highest commodity prices over the past three years contributing to exceptional performance. The dip in the five year performance illustrates the exposure to climatic and price volatility but also shows the resilience of farmland to recessions compared with commercial and residential property. These asset classes recorded significantly negative total returns during 2008 and 2009 due to falling capital values in these sectors.

Although there has been volatility in farmland investments it has not been as significant as commercial and residential property as shown on Graph 9. This illustrates the relatively low risk combined with a strong return. Apart from forestry, farmland has been the least volatile but annualised returns over the past 15 years more than doubled. The risk and return profile of US commercial and residential investments show more volatility and a lower return over the past 15 years. Our analysis points to a levelling out of this volatility over the past three years as performance has improved, also shown in Graph 10.

In the UK, the trend has been similar, but slightly more muted, with the investment performance of farmland (in hand farming and let land) outperforming most other assets over the past 10 years and has been comparable with alternative assets over the past 15 to 30 years. The strong performance of farmland, its relatively low risk over the medium to long term and its inverse correlation to alternative assets ensures it provides added value to a mixed asset portfolio. We expect the investment performance of farmland to remain strong although we do expect it to become more comparable with commercial and residential property over the next few years as the macro economic situation improves.

The US’s five world cities attract a wide range of overseas investment for a variety of different reasons.

Global investors and occupiers are now more focused on the US as a region that looks relatively sheltered from the headwinds blowing from across the rest of the world. It may have remained longer in recession and seen its real estate markets fall significantly after 2007, but both the economic and real estate recovery have been marked.

Savills 12 Cities report takes a look at all its following world cities; New York, San Francisco, Chicago, Los Angeles and Miami, which each have their own characteristics but are known globally. As such, they command world city status and attract, for different reasons, a wide variety of overseas investment while playing host to a wide range of international companies and enterprises.

US Cities: Global investors are looking west

Words: Yolande Barnes
With the right product in the right place, US farmland and agriculture in the US can offer real opportunities for top investment performance. This is underpinned by the fundamentals of food and energy security. However, commodity price fluctuations are likely to have a more direct effect on value growth in the US where values are closely related to farm profits, this is in contrast to areas where the demand from non-farmers is a real driver such as the UK.

As reported on pages 8 and 13, variations in current value and growth over the past decade have been significant. The main grain producing areas have recorded the fastest value growth. However, we expect the current fall in commodity prices to reduce profits and for cash flow pressure to have the greatest impact here. Also around a third of corn production is used to produce ethanol.

Therefore, any falls in ethanol and overall fuel use is likely to add more pressure to prices.

Levels of debt are now lower than in the 1980s and the latest five-year farm bill signed in February 2014 will reduce exposure to commodity price volatility. When combined with relatively low farmland supply all these factors will help support any short term downward pressure on values.

Serious consideration US farmland should be a serious consideration for investors looking for scale, high value niche markets, and the opportunity for a reasonable income yield, these are difficult to achieve in the UK, as well as medium to long term capital growth in a mature and transparent market.

In addition, the US is accessible in terms of trade, travel, and finance, and purchasing US farmland can preserve UK tax advantages for the UK investor. We expect demand from these buyers to also add a level of support to the US market, especially as there are significant sums of money available to diversify relatively small proportions of total investment portfolios.

Other opportunities to enhance value including strategic development and minerals should not be discounted. Although, due to the size of the US, these are significantly fewer than in more densely populated countries such as the UK and tend to be long term in nature.

Levels of debt are now lower than the 1980s

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