Spotlight on International Farmland Markets

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International farmland markets

With an increasing interest in this sector in terms of investment, farmland values on a global scale continue to strengthen

Introduction

Investment in farmland has for many years been the preserve of farmers and wealthy families and for all but a few, of little interest to international investment houses. As concerns over food security become greater and the use of land for agriculture comes under pressure, the financial sector and some governments/sovereign wealth funds have now joined the increasing numbers of private Investors who are now appraising the investment opportunities. Some have already invested in the sector.

Their motives differ; the financial investors seek long-term risk adjusted returns and portfolio diversification, while governments and sovereign wealth funds are looking for surety of the long-term supply of foodstuffs.

Food consumption is expected to double by 2050, with both the world's population forecast to grow by over 40% (an extra 2.7 billion people) and also an increase in the demand for higher protein diets as the emerging markets become wealthier.

At the same time, production/supply is expected to shrink, with pressure from a wide range of factors including urbanisation, climate change, the demand for bio fuels and rising input costs.

In order to go some way towards counter-balancing this, substantial investment in agri-technology and farming, will be required to deliver efficiencies throughout the agriculture sector and the food industry.

Land values

The straight line trend for international farmland values has remained positive; however the recession has affected levels of growth in some countries.

We expect the basic economics of supply and demand will continue to support farmland values globally.

Inside this edition

Returns will vary in absolute terms and the degree of volatility will depend on a number of factors. These include whether a farmland investor has elected to either participate in the business of farming with its higher returns/risk profile, or take the more stable returns of cash rents as a landlord. Other factors include location and enterprise selection. As always, diversified portfolios will help smooth out volatility.

We believe international land values will continue to strengthen, although at varying rates between locations. Also that farmland as an asset will increasingly become a sought after investment.

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Farmland as an asset class

The agricultural sector worldwide has proved itself to be an attractive and stable investment, but what are the opportunities and challenges to consider?

Investment characteristics

In addition to the increasing global demand for food, the 2008 world economic crisis has made the long-term stability of agriculture look very attractive. Agricultural land can produce reasonable cash flows, is a tangible asset and a good inflation hedge. It also has a low or negative correlation with other traditional asset classes such as stocks and bonds, giving an interesting portfolio diversification. In some markets within the EU, including the UK, there are also attractive tax breaks.

Challenges for new investors

While many potential investors now understand the strong macro arguments for investing in agriculture, few institutional and private investors have the in-house agricultural investment and management know-how.

For new entrants into the agricultural sector, one of the main challenges, alongside understanding the investment opportunities and risks, is establishing how to invest in this relatively illiquid asset class. The various investment strategies and options are:

- Direct investment
- Managed fund
- Operational farming (on owned or leased land) or:
- Pure land ownership with land leased to farm operators

Which geographical areas are of interest and what are the most suitable enterprises, including their environmental impact? One thing that is common to all of the above is that agriculture land should be considered as a medium to long-term investment.

Land market fundamentals

Land prices vary significantly between regions and within countries. For example, in Brazil similar land with the same productive capacity can be four times more expensive in one region compared with another. In the EU prices for similar quality land can vary by a multiple of ten across the region. So why are there these large variations?

Global – At a global, level the strongest driver of land prices is productive capacity, with the anticipated supply and demand of agricultural commodities impacting on stocks and therefore price.

National – At a national level, the impact is on net prices and production costs. This is affected by the amount of usable land and farm sizes, land ownership restrictions, subsidies, taxes, availability of finance and the strength of the economy. Foreign ownership of land is an emotive issue and there is an increasing concern by some governments about the foreign ownership of land, with tighter restrictions or approval procedures being put in place in some countries. Restrictions on land ownership can significantly depress values.

Farm – At the farm level, productivity and the associated costs relating to soil quality, climate, water availability and location (proximity to transport links and processors) all impact on profitability and are the main drivers of value.

Where in the world?

A broad geographically spread portfolio is attractive for risk diversification.

Investors looking to invest in farmland purely for wealth preservation, as part of their portfolio diversification strategy, will find the developed markets more appropriate, even though values are higher, reflecting the sophistication of the agricultural industry. These include Western Europe, USA, Canada, Australia and New Zealand.

Potentially higher returns are possible in emerging or even frontier markets, where entry values are low or agricultural production is currently underperforming. Opportunities in emerging markets exist in parts of Central and Eastern Europe (CEE) and South America. Opportunities in the frontier markets include sub-Sahara Africa.

The opportunity to capitalise on increasing income by injecting funds and skilled management, as well as other factors (e.g. recent EU membership in Central and Eastern Europe) could be an additional attraction.

Diagram 1.
Why invest in farmland?

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Investment returns

Financial investors, as opposed to investors seeking food security, are motivated by both the potential for capital appreciation and increased income returns; their focus is a carefully timed purchase and subsequent disposal.

Higher, but more volatile returns are typically achieved from exposure to operational farming business. Whilst the returns to the landowner from cash rents are normally lower, but more stable. As you would expect, annual returns in the most mature markets are lower than those in emerging markets.

Agricultural investment funds which, own rather than lease land around the world (Australia, Central and Eastern Europe, New Zealand, South America and the US), are typically forecasting cash-on-cash returns in the range of 3-8% + p.a. and Internal Rates of Return (IRR) of 10-18%, after fees.

In the UK, over the past 30 years the investment performance of farmland has been similar to many other assets, the main exception being residential property and equities (see Graph 1). However, in more recent times (the past 15 years) and again illustrated in Graph 1, farmland (let and farmed in-hand) has actually outperformed all assets except residential property.

Over the past three years, farming and forestry have topped the investment performance league in the UK. In the USA where there is a developed land investment market, with considerable institutional and private investment in let land, the trend has been similar as illustrated in Graph 2.

Agricultural land has shown it is a tested store of value in inflationary environments. In addition, the returns from agricultural investments have a weak correlation with mainstream investments, which means agricultural property performs well when other assets show poor returns. This is an argument for including agricultural property in a mixed portfolio, to reduce risk and also boost overall portfolio performance.

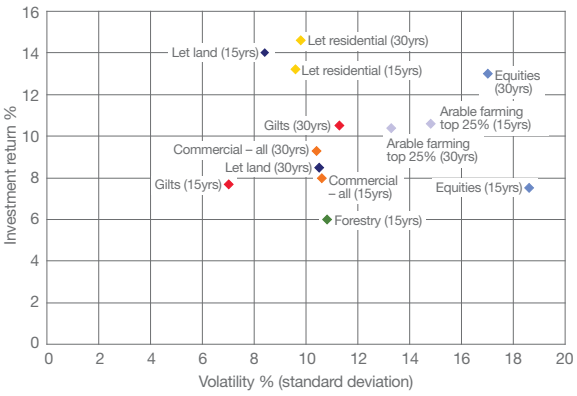
The stable returns of agricultural property during the past few years, also indicates that this asset is largely recession proof. The trends highlighted have generally been replicated in many markets around the world.

We expect strong investment performance to continue across the world as fundamentals of food production, security and renewable energy all impact on the finite area of global farmland.

Although the straight line trend is still positive, the worldwide recession has put some pressure on farmland value growth in a few mature markets within Europe where values were the highest e.g. Ireland, Denmark and the Netherlands.

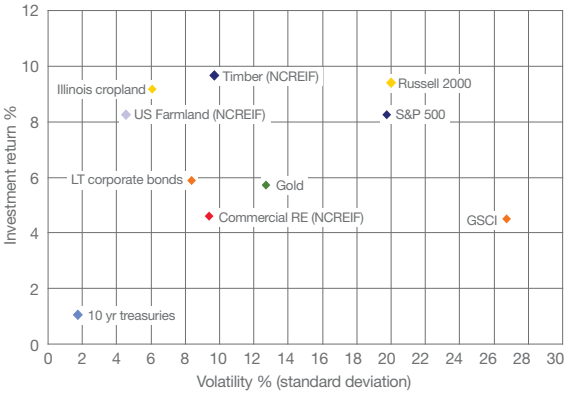
Our commentary (see overleaf) provides an overview of the various international farmland markets. As you will notice, there are significant variations between regions and within countries.

Graph 1.
UK Investment Performance – Risk and Return



Source: IPD/Savills Research

Graph 2.
US Investment Performance – Risk and Return



Source: HighQuest Partners, NCREIF (1991–2009)

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An overview of international values

Understandably the rate of growth in farmland values across the globe can vary significantly between locations. Here is our guide to national markets

Western Europe

During the past few years the general trend for value growth across Europe has been upward, but the recession has dampened the fast growth rates recorded between 2005 and 2008.

Our Farmland Value Survey shows the average value of Grade 3 arable land across Great Britain rose by 3.5% during the third quarter of 2010 to £5,180 per acre. This puts the cumulative growth for the first three quarters of 2010 at 9.7%, compared with the 6.7% growth recorded for the whole of last year. Average values are now higher than at their previous peak of June 2008 (£4,895 per acre).

The highest land values are still recorded in Northern Ireland, Ireland, Denmark and the Netherlands, although it is across these countries where significant correction has been witnessed during the past two years and anecdotal evidence suggests this has continued into 2010.

In contrast, values have been relatively stable in some other countries. In France this has been particularly so, as a result of the organisation SAFER having to approve all land acquisitions. SAFER encourages sales to local farmers, making it more difficult, but not impossible, for outside investors and non farmers to purchase land, which in turn dampens land value growth.

"During the past few years the trend for value growth has been upward but the recession has dampened the fast growth rates recorded between 2005 and 2008."

Central and Eastern Europe – EU

Looking at the Central and Eastern European (CEE) countries within the European Union (EU), see Graph 4, we can see that the general trend in values has been positive, especially following accession into the EU of most of these countries in 2004, with Bulgaria and Romania following in 2007.

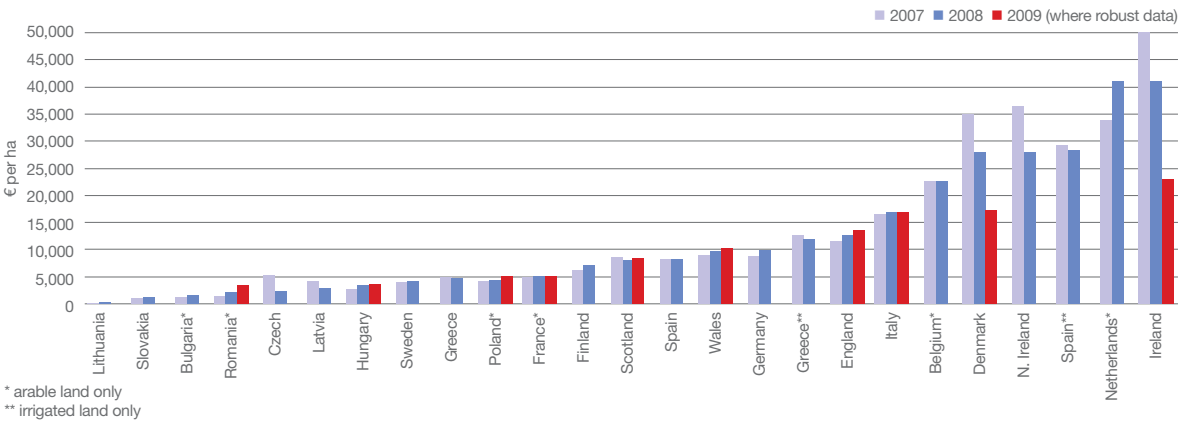
The key reasons for this upward trend are the introduction of CAP subsidies and an improvement in their economies following entry into the EU. In addition, although with restrictions, entry into the EU opened up their farmland markets to foreign investment. By 2008 Polish values had risen to levels similar to France, Sweden and Finland.

Across the CEE, there are restrictions in place on the foreign ownership of farmland for set derogation periods post EU membership. For example, in Poland twelve years and Hungary seven years, with a possible extension of three years.

However, in most cases local CEEC companies owned 100% by foreigners can buy land with some exceptions including Hungary. Values in Hungary have been slower to grow compared to some other CEEC markets, due to the general heavier ownership restrictions imposed on this market.

We expect to witness further consistent growth in values across the CEECs. They are large countries with rich agricultural soils. With the correct investment in resources and infrastructure (roads, ports and processors), they are ideally positioned to capitalise on the effects of rising global populations, increased wealth and the demand for renewable energy, all leading to increased profitability.

Graph 3.
European Values including CEEC



* arable land only
** irrigated land only

Source: Savills Research using Eurostat & various data/estimates

Eastern Europe – Russia and Ukraine

Land values in Russia are difficult to reliably ascertain and leasing land is often the easiest route to farming there. There is some evidence to show that current land values are around US$250 to US$800 per ha, depending on the completeness of registration and the accompanying infrastructure. The recent drought and difficult weather conditions, has put downward pressures on land values.

In Russia, 49-year leases are common. Foreigners can own companies that own land through cross share ownership, but land ownership can be a difficult process, often taking more than a year to achieve land registration. However, this can more than double the value of the investment.

In the Ukraine only leases are available for farmland. These are typically 15 years. Key money for securing tenancies has seen downward pressure as a result of the recession and drought.

"New Zealand has the advantage over many areas in that water is abundant due to reliable rainfall, and a good irrigation infrastructure…"

Australia and New Zealand

In New South Wales, Australia farmland values remained relatively static in 2009 (see Graph 5). The average value of wheat properties increased just 2% to AUD 1,275 per ha and the premium grazing land by 4% to around AUD 2,700 per ha for tablelands grazing and AUD 2,966 per ha for coastal grazing.

Australian agriculture is fundamentally based on extensive pastoral and cropping activities. However, diversification into intensive livestock and horticultural enterprises is increasing.

Australian agriculture is seen by many large local and international investors as a 'safe' place to invest and this is enhanced by the increasing wealth of Asian countries which are major agricultural export trade partners. In addition, the Australian economy is strong and the political risk is low.

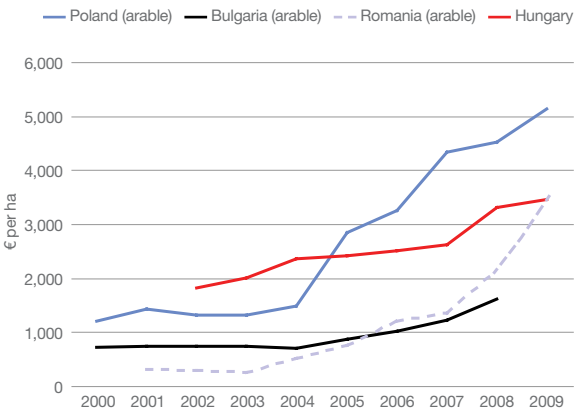
In 2009 the value of farmland in New Zealand came under pressure in the pasture sectors (see Graph 5). The average value of dairy farms fell by -8% in 2009 to NZD 31,300 per ha. The average value of fattening and grazing farms fell -10% and -13% respectively.

This reduction was primarily due to the drop in milk prices in 2008/2009. Although milk prices have recovered the growth in land values has been stifled by the continuing tight credit conditions. These factors created a situation that had an immediate impact on asset values, as in much of New Zealand asset prices are underpinned by the performance of the dairy sector.

In contrast, the average value of arable farms in New Zealand increased 7% to almost NZD 34,000 per ha.

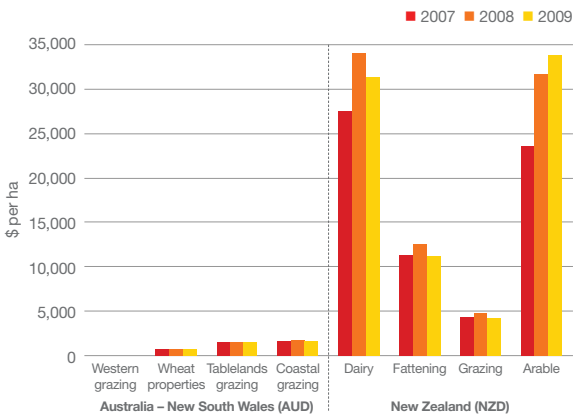
The Government has recently put in tighter approvals procedure for foreign acquisitions of land, to ensure it is in the national interest. This may dampen any future strength in the market.

Graph 4.
CEECs



Source: Savills Research using Eurostat & various data/estimates

Graph 5.
Australia and New Zealand Values



Source: NSW Lands Department & Quotable Value

USA and Canada

In 2009 average farmland values across the USA increased by 1.4% although they are still -1.4%, lower than the peak of $5,362 per ha in 2008 (Graph 6), caused by the commodity price spike. This pattern applied to average values for both cropland and pastureland. Favourable tax and interest rates, farm programmes, a lack of alternative investments and short supply all contributed to the strengthening of values in 2009.

However, there are some ownership restrictions in the USA, for example there are some areas of the Midwest where companies and foreigners can not buy land, which is one reason, in addition to the lower population density, why the US land values look relatively good value, compared to those in Western Europe.

In Canada average values have continued to rise steadily (see Graph 6) with average values increasing 4.6% in 2009 to $3,160 per ha.

In western Canada, states such as Saskatchewan do not permit foreign ownership of agricultural land, whilst in some other states foreigners can own up to 49% of the shares of a company which owns land. In eastern Canada however, there are no restrictions and this is reflected in the higher land values.

Brazil

The average value of farmland across Brazil increased 5% in the year to December 2009 to R$ 4,600 per ha, 350% since 2000 and 40% since December 2006 (see Graph 7). The annual rate of growth has now tempered. The rise in land values has been driven by food security and foreign investors, as well as local investors driven by the success of the Brazilian capital markets on the back of the strength of its economy.

Graph 7 also shows that the farmland with highest average values is located in the southern regions of Brazil, with average values reaching almost R$ 9,500 per ha due to the best soils, infrastructure and access to markets. Tighter supply is also a feature of the market in these regions.

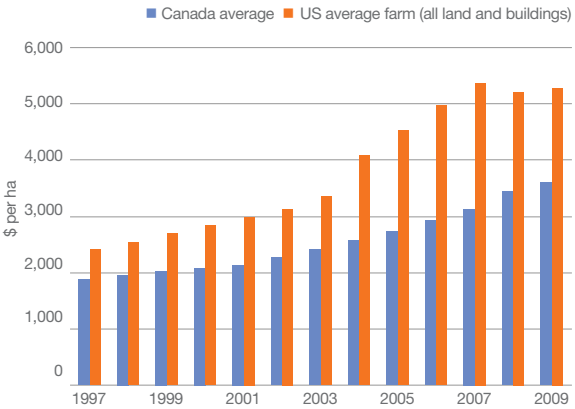
It is expected that new infrastructure projects will give a boost to land values in other regions. For example, a new railway being built through the centre of the country, including the Maranhao and Tocantins states, should help improve logistics and increase land values here in the future.

Agricultural land and commodities are major investment topics in Brazil. Brazil has many natural advantages including fertile soil, an unlimited supply of water and an abundance of land. With 19% of the world's arable land, Brazil is one of the world's top eight producers of 28 different agricultural commodities. Brazil is the world's biggest exporter of soya beans, coffee, sugar cane and oranges.

The Government has introduced laws making land ownership by foreigners more restrictive. We beleive this will only affect those investors looking to deploy significant amounts of money or in areas where there already has been a large amount of foreign investment.

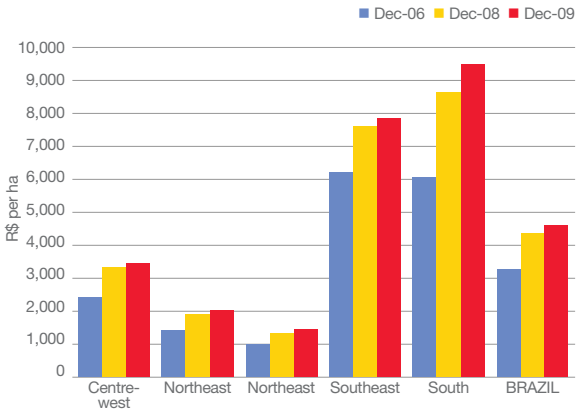
"A lack of alternative investments and short supply contributed to a strengthening of US values in 2009."

Graph 6.
USA and Canada



Source: Statistics Canada, USDA

Graph 7.
Brazil



Source: Savills Research from Brazil Agrianual 2010

Argentina/Uruguay

First quality agricultural land values in Argentina have increased by two and a half times since 2003 and almost four times for second quality agricultural land, reflecting the demand from foreign investors who are attracted to Argentina and the rest of South America (see Graph 8).

The average value of first quality arable land is estimated to have increased 33% during 2010 to around US$14,000 per ha after falling -11% in 2009 due to pressure from the fall in commodity prices after the 2007/08 spike. However, there has been surprisingly few farms available to buy, as the current owners cannot find another asset class which is denominated in US$ and also provides an inflation/ recession hedge.

Argentina is an attractive area for agricultural investment, as there is good value quality land, the potential to farm large areas with good legal title, sophisticated farming techniques and probably the lowest production costs in the region despite the imposition of export taxes.

Generally, markets are well established and water availability is good. Low costs and the potential for high productivity offer good investment opportunities, but location is critical. Some foreign investors have been put off by the stance of the current government towards the farming sector. However, the Presidential elections in 2011 may lead to a change in attitude in the future.

The perception of a lower political risk in Uruguay has meant that investors have seen prices rising to between and to the point that returns are now less than in Argentina. Land values in Uruguay for good quality land typically range from US$3,750 to US$9,000 hectare, but farmland is not generally as good as in Argentina, with typically more mixed farming operations and lower crop yields. Most farms would have a mix of perhaps arable, cattle and forestry enterprises, as well as larger areas of unusable land.

Africa

African farmland is receiving an increased level of attention, especially from sovereign wealth funds in countries which are keen to secure land to grow food for their own populations.

Many of the countries in sub-Saharan Africa do not allow land ownership but land is generally available on long term leases. Graph 9 gives a flavour of average land values across Africa where land ownership is permitted and therefore a market exists.

Graph 9 illustrates the benefit of irrigation, although there are no clear boundaries between either irrigated or dry land. This is region dependent and on the amount of water available.

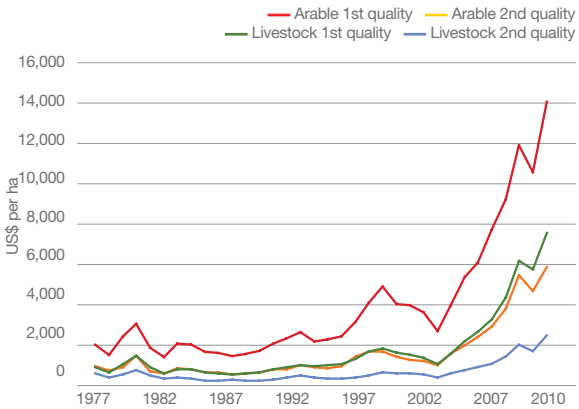
Overall, investment in African farmland is often perceived as fairly high risk, due to pressure on the Governments to deliver against their land reform promises and other political concerns. With land claims being resolved, this is creating a more stable ownership profile. In addition, there is now a more open structure and better organisation between African governments to engage directly with private investment groups.

Although crop yields, soils, weather, crime, water availability, electricity constraints and labour relations might be risks often highlighted in the press; they are often manageable and increasingly positive factors acting as catalysts for investment.

A recent FAO report claimed that out of a possible 26% of arable land in Africa, only 13% of land was cultivated, leaving significant scope for large scale agricultural development, for those more adventurous investors with a higher reward/risk profile.

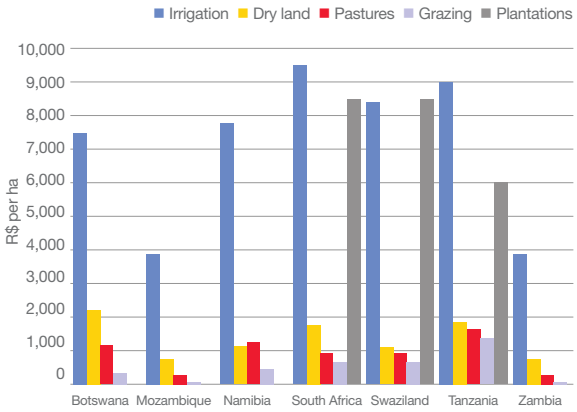
> "There is now a more open structure and better organisation between African governments to engage directly with private investment groups."

Graph 8.
Argentina



Source: Márgenes Agropecuarios

Graph 9.
Africa



Source: Rian Lazenbury

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Summary and outlook

■ For most mainstream institutions, investment in agriculture is yet to appear on the agenda, but we believe this will change over the next few years. In the shorter term, we expect demand for agricultural investments from family offices, financial investors and also the sovereign wealth funds to increase. This interest will be fuelled by simple supply and demand economics supporting long-term growth projections for the agricultural industry, food security, as well as the attractions of this asset class.

■ World farmland markets are becoming increasingly accessible with new emerging markets opening up, creating new opportunities. However investments should be structured sensitively to avoid concerns over large-scale farmland acquisitions by foreign nationals.

■ Returns will vary in absolute terms and in terms of the degree of volatility, presenting a strong argument for diversified geographical portfolios to smooth out the differences.

■ There is a merit for including farmland in a diversified investment portfolio, due to its attractive investment characteristics, including its low correlation to other asset classes, stability and inflation hedge track record.

■ Farming is a detailed day to day business. Investors therefore need to ensure that strong local management teams or operators are in place to farm the land.

■ We expect that the macro factors of commodity supply and demand fundamentals will support a continued trend of rising land values worldwide, although the rate of growth will vary between locations. We believe, farmland as an asset will increasingly become more prominent as a sought after asset. ■

"We expect that the macro factors of commodity supply and demand fundamentals will support a continued trend of rising land values worldwide."

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