

60-second summary

Investing in agriculture



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Agricultural investments can deliver income and capital appreciation while offering low volatility. But the asset class is also illiquid and exposed to specific risks. Here we provide a summary of the investment case for farmland and its potential risks.

What is farmland investing?

The ownership of agricultural land can generate returns both from land value appreciation and from income. Income can be derived from lease payments or from the sale of the commodities produced on the property. The asset class offers resilience to the economic cycle due to a number of factors:

1. constant and growing food demand;
2. diversification, given its low correlation with traditional and alternative asset classes; and
3. inflation protection, since the commodities from which returns are derived have a significant impact on inflation rates.

There's been over \$50 billion of institutional investment into farmland, and fund managers investing in farmland estimate the global investible universe to be c. \$1.2–2 trillion.

Why do funds invest in farmland?

Demand for food is rising as populations grow, with middle classes in developing countries intensifying their appetite for higher-value foods. In addition, consumption of biofuels is increasing as countries diversify their energy bases. But there's a finite amount of arable land with appropriate soil and water resources. So, the essential increases in food output must come from improved productivity via technological advances or from previously unused fertile land.

Where do funds typically invest?

Diversifying across a range of geographies is key to risk mitigation in this asset class. Institutional investment in farmland is predominantly focused on the US market. However, including some limited exposure to developing economies in a portfolio could potentially increase returns via higher economic growth and the potential to improve farm production in less efficient markets.

Performance history

Farmland has historically delivered low volatility with attractive risk-adjusted returns relative to other asset classes, particularly equities and bonds. Return drivers include income, capital growth and 'value add', through active management and investments in related companies within the supply chain. According to the US NCREIF Index, farmland produced returns of around 11% pa, with volatility of around 6% pa from 1997 to 2022. These returns can largely be attributed to the inelastic demand for food, while the relatively illiquid nature of the assets is a driving factor of the relatively low volatility.

Agricultural investment vehicles

Offerings vary in focus not only between crop types, geographies and operating strategies (from leasing land to directly operating the farm), but also in the structure of the funds themselves. Options include: separately managed accounts, where the institutional investor directly owns and controls each investment; or pooled funds. Pooled funds can either be closed-ended, where capital is locked away for a specified period of time, or open-ended, with no end date. Open-ended funds typically buy assets for the long term with a focus on distributing income to investors for the duration. Some real estate investment trusts also focus on farmland.

Asset-class-specific risk factors

Environmental risks impacting crop yields range from changing weather patterns and availability of high-quality water to catastrophe risk. Macroeconomic factors affecting crop prices include government regulations, particularly subsidies, and changing consumer preferences. In terms of operational risks, managers leasing land to farmers introduce rent-collection risks. Similarly, where a manager owns and operates a farm, supply of key inputs or local employment issues can impact farm profits. Investment risks include market illiquidity and inefficiency compared with traditional asset classes, with other factors relating to tax and currencies when investing overseas.

ESG risks and opportunities

It's in farmers' interests to protect the soil and increase production, so sustainability considerations are part of their normal business. However, innovations can improve the ESG credentials and sustainability of farmland, focusing on more efficient use of limited resources through agriculture technology, genetics and improved crop management. Positive environmental benefits of sustainably managed farmland include climate-change mitigation, through carbon sequestration and reductions in traditionally high operational emissions; biodiversity and land protection; water conservation; and by contributing to community prosperity in rural areas.

ESG data and metrics

While it's possible to estimate carbon sequestration, it's difficult to accurately measure. Managers often use ESG-related KPIs to assess their assets, many of which are directly linked to the UN's Sustainable Development Goals, including measures of crop productivity, water-use efficiency and renewable-energy capacity.

Summary

Farmland fund managers adopt a variety of approaches between different geographies, crop types and operating strategies. There is, therefore, a range of risk and return targets depending on the fund chosen. To mitigate risk, building a diversified portfolio of farmland assets is key. This includes diversification by geography (spreading exposure to weather, currencies and governments), crop type and ownership strategy. Manager knowledge, due diligence and active management techniques are also essential to identifying and managing risks.