THE CASE FOR FARMLAND INVESTMENTS

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03/28/2018

Last Friday's podcast featured an interesting discussion on farmland, an asset class we do not spend a lot of time talking about but one that could make an interesting allocation for those expecting a pickup in inflation.

The two guests from the show invest in farmland in very separate structures—one was Paul Pittman, the CEO and founder of a public farmland real estate investment trust called Farmland Partners, and the other was Brandon Zick, who oversees land acquisitions for Ceres Partners, a private real estate fund.

Lack of Institutional Investment in Farmland: Both Pittman and Zick emphasized how farmland remains a very scattered and noninstitutionalized market—meaning most of the asset owners are farmers themselves. Only 2% of farms are owned by institutional investment funds like the ones Zick and Pittman operate, and that creates inefficiencies and opportunities to add value, in their opinion.

The farmland assets that both Pittman and Zick represent are more akin to traditional real estate investments in that farmers pay rent to landowners like Pittman and Zick. This shields the cash flows from the volatility of agriculture prices that farmers assume, but the long-run appreciation is tied to the value of the land.

Zick's firm looks to acquire farms with a 5% cash flow yield, and he expects to be able to get land value appreciation over time. The dividend yield on the Farmland Partners REIT has moved up given negative sentiment in the REIT, and Pittman believes his share prices are selling at a sharp discount to Farmland Partners' internally calculated net asset value, so he is also buying back shares to the extent his cash flow, debt and asset sales allow.

The bullish case for agriculture prices over the long run is a play on emerging market consumption growth, as the biggest driver of food consumption worldwide will be growth in per capita income in the large population countries such as India and China—so farming also is a play on emerging market growth.

I had the opportunity to meet Zick at Camp Kotok in Maine last August and was intrigued by the investment approach of Ceres Partners. The cash flows that are generated by the rental income paid by the farmers—in addition to the land appreciation that comes over time—make this an intriguing asset class with few vehicles that deliver this exposure.

To hear more about how both Pittman and Zick invest in farmland and the opportunities each of their firms can give, listen to our full conversation on our "Behind the Markets" podcast here.

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DEFINITIONS

Real estate investment trust (REIT) : Investment structure containing a basket of different exposures to real estate, be it directly in properties or in mortgages. Returns predominantly relate to changes in property values and income from rental payments.

Cash flows : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Net Asset Value (NAV) : The calculated assets minus liabilities divided by shares outstanding. NAV is the straightforward account of the actual assets in the fun.

Bullish : a position that benefits when asset prices rise.