




## The best long-term real estate investment: Farmland

Published: 24 Mar 2014

Short URL: <http://farmlandgrab.org/23308>

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CNBC | 24 March 2014

### The best long-term real estate investment: Farmland

by Richard McGill Murphy

From his office on Broad Street in lower Manhattan, Jeff Notaro oversees a modest portfolio consisting mainly of dirt. Specifically, Notaro's Black Sea Agriculture fund invests in farmland in northeastern Bulgaria, near the Black Sea. The \$1.5 million fund buys prime agricultural land and leases it back to local farmers.



Investors continue to buy up farmland like this in Bulgaria as a long-term investment plan. (Photo: Black Sea Agriculture)

Notaro is riding a growth market. Since 2004, Bulgarian farmland has been appreciating at an average annual rate of 19 percent. Yet Bulgarian land is still cheap compared to the United States. The average price per acre for good-quality land is \$1,850 in Bulgaria versus \$5,000 an acre in Kansas.

Land along the Black Sea coast commands higher prices because it's especially fertile and also close to deep-water ports. Black Sea wheat land costs \$4,300 an acre on average but yields an average of 71 bushels of wheat an acre, compared with 42 bushels an acre in Kansas. "That's about half the cost per acre on a yield basis," Notaro said.

The rise in local land prices has been fueled mainly by a worldwide agricultural commodity boom that has driven food prices up by more than 100 percent since 2003, according to the Food and Agriculture Organization of the United Nations (FAO).

"More people need to get into farming; otherwise, we won't have any food," said commodity investor Jim Rogers, who launched the international Quantum Fund with George Soros in the early 1970s and went on to create the Rogers International Commodities Index, which tracks the performance of numerous commodities in global markets, ranging from agriculture to metals and energy products.

Rogers and Notaro belong to an increasingly active community of farmland investors hoping to profit from the world's growing need for nourishment. "I'm still wildly optimistic about the future of agriculture worldwide," said Rogers, who has served as an advisor and as a director to companies that hold farmland in Australia, Brazil and North America.

The outlines of the investing case for farmland are well known at this point. The global population is expected to peak at slightly more than 9 billion by 2050, up from 7 billion today. On a per capita basis, the FAO projects that the amount of arable land available will decline steadily over the next few decades, from 0.218 hectares per person today to 0.181 hectares per person in 2050.

On the demand side, much of the growth in population and food consumption will occur in the developing world. As income levels rise in developing countries, consumers there are consuming more meat. Livestock production consumes massive quantities of grain and water, spurring farmers to boost both crop yields and land under cultivation.

Soaring demand for biofuels is another significant demand factor. In the U.S., for example, ethanol production accounts for 23 percent of total corn utilization, according to the Renewable Fuels Association.

Average U.S. corn prices tripled between 2005 and 2012, from \$2 a bushel in 2005 and 2006 to \$6.22 a bushel in 2011 and 2012. The price surge was partly caused by a rising demand for ethanol, along with other factors, including flooding and drought, higher prices for inputs like fuel and fertilizer, rising demand for meat, and upward movement in commodity markets.

In turn, rising agricultural commodity prices have driven a 128 percent rise in average Midwest farmland values over the past decade, from \$1,270 an acre in 2003 to \$2,900 an acre in 2013,

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### The world's insatiable appetite

On the supply side, crop yields have been leveling off since the dramatic advances of the last few decades, starting with the Green Revolution that transformed agriculture in China, India and elsewhere in the developing world from the 1960s onward. Today 40 percent of global wheat land is experiencing either flat or declining yields, according to a 2012 article in the journal *Nature Communications*.

In China, local scientists recently warned that smog levels around the country have risen so high that they are blocking natural light, potentially impeding photosynthesis and creating conditions that resemble nuclear winter.

"We're seeing land under threat globally," said Reza Vishkai, head of specialist investments at Insight Investment Management in London. "You can raise production by increasing land under cultivation, but a lot of that land is concentrated in places like Africa and Brazil and requires huge investment to operate on a profitable basis."

Owners of quality farmland are poised to benefit from all these trends, which explains why so many agriculture investors are bullish on land. Over the next two years, Notaro hopes to boost the size of his Black Sea Agriculture fund from \$1.5 million to at least \$10 million. This should put him in control of at least 5,000 acres, depending on where land prices head in the near term.

As in many emerging markets, farmland investing in Bulgaria is essentially a consolidation play. After Bulgaria's Communist regime collapsed in 1990, the new government returned huge expanses of state-owned farmland to its pre-Communist owners. These families often inherited plots of 10 to 15 acres, too small for farmers to realize significant economies of scale.

"The small holdings, in general, are undervalued," said Notaro. "Local farmers accumulate all these little leases and farm them with small equipment over poor roads. The Black Sea coast has some of the best topsoil in the world, but it's not producing what it could."

Black Sea Agriculture has acquired 346 acres of Bulgarian farmland over the past two years, mostly devoted to wheat cultivation and currently valued at about \$1.5 million.

In the Bulgarian farmland market, values rise sharply with the size of the holding, because larger holdings permit more mechanized, more efficient and thus more profitable farming. On a per-acre basis, a 75-acre plot currently sells for about 40 percent more than a four-acre plot. "There are not a lot of large plots available, and local farmers are willing to pay up to acquire them," Notaro said.

As a European Union member with a reasonably stable economy and political system, Bulgaria offers some security for risk-averse investors. The same can't be said for some of the edgier emerging markets. This can open opportunities for impact investors such as Stewart Paperin, president of the Soros Economic Development Fund (SEDF), a \$350 million nonprofit fund affiliated with George Soros's Open Society Foundations.

SEDF invests in South Asia and throughout Africa, where Paperin recently took a \$5 million stake in a Ghanaian rice farm and put \$300,000 into a goat abattoir in Zimbabwe. "Our first test for a potential investment is whether there's a social benefit," said Paperin. "Next, it's whether we can make money."

### Supply-side economics

SEDF's nonprofit structure and social mission allows it to take on slightly more risk than most traditional for-profit investors. "I can accept a longer time horizon and marginally lower returns," said Paperin. "As a for-profit fund, I would need a 30 percent to 35 percent risk-adjusted return to go into Sierra Leone, which means that I probably couldn't do it."

So far, the farmland investing world has been dominated by institutional investors that can sink capital and management expertise into highly illiquid assets located in far-flung markets. Some of the more attractive markets include countries that offer both reasonable land prices and political stability, such as Australia, Bulgaria, Chile, New Zealand and Uruguay.

Options for individual investors include the perennially volatile commodities markets, as well as equipment and fertilizer manufacturers, food processors and the various exchange-traded funds that focus on agriculture, such as the Market Vectors Agribusiness ETF (NYSE:MOO) and the PowerShares DB Agriculture Fund (NYSE:DBA).

"Individuals can use the public markets to get exposure to the broader food story," said Vishkai. "But from a risk/return perspective, it's a very different kind of investment. These are equities, and they behave like equities." As an example, Vishkai noted that the DAX Global Agribusiness Index declined by 60 percent during the broad market downturn of 2008 and 2009. U.S. farmland prices rose in both those years.

Rogers has one piece of advice for retail investors with a thirst for agricultural exposure. "The best thing you can do is become a farmer, assuming you know what you're doing," he said jovially. "I

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imagine I'd be terrible at farming, as I know nothing about it and have no experience. That's why I stick to investing."

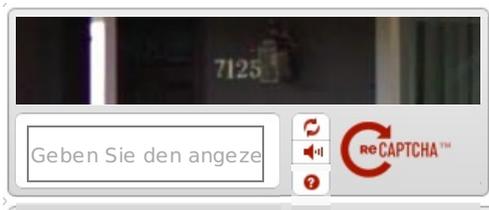
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