Mick Keogh

Executive Director

Australian Farm Institute

Factors that affect the demand for, and hence the value of farmland are many and varied, and often poorly understood. Many farmers complain that land values are unsustainable relative to earning capacity, yet existing landholders are often the most aggressive purchasers of additional land. International and corporate investors often seem to place a higher value on farmland than existing landholders, but many question whether these investors ever generate viable returns.

Ultimately the value of land is what a purchaser is prepared to pay, however the perception of 'fair' value relative to the productive capacity of the land is a very uncertain concept. That uncertainty notwithstanding, land values appear to be impacted to a significant degree by relative farm profitability. Other factors affecting land value include government regulations that impact on title security and land use practices and the presence of transport infrastructure or perceived amenity value. Land title security also impacts on farmers' access to finance, which in turn can affect land values.

Understanding all these different factors is a challenge, and the aim of the papers included in this edition of the *Farm Policy Journal* is to obtain a better understanding of current knowledge about factors and trends that are evident in both the value of farmland and the methodologies that are used to assess value.

The first paper, written by Tim Lane of Herron Todd White, discusses the methods used to value agricultural land in Australia. Traditionally land in Australia has been valued on the basis of direct comparison with sales of similar farms in a district or region. The paper discusses the original concept of market value, along with different methodologies utilised to determine values within the agricultural industry. It explores some of the underlying factors of valuation, showing reasons why a standard investment indicator may not be the best indicator. The paper argues that agricultural land as a pure investment in isolation (excluding operating returns) may not be attractive for institutional investors. The main requirement for institutional investors is regular returns to keep shareholders content. It is clear from this paper that farmland valuation is an inexact science, and that the subjective techniques utilised have layers of underlying information along with many challenges.

The second paper by Mark Henry of the Australian Farm Institute discusses the effects of financialisation on farmland values, as farmland becomes more seriously considered as an investment asset for non-farming investors. This paper explores the current pricing mechanisms for Australian farmland and identifies that the returns farmland generates as an asset are highly dependent on managerial skill. It analyses the attractiveness of farmland investment models for investors citing the farmland rental markets in the US Corn Belt and the UK as profitable examples. The paper identifies that such models have not developed to anywhere near the same level of liquidity in Australia, a result being that Australian farmers have much more limited access to non-debt funding models. One method to facilitate investment is to utilise farmland investment management platforms or organisations, with a number emerging in Australia in recent times. Recent performances suggest that these investment models have not yet been able to consistently meet investment yield expectations.

The third paper is by Professor Charles Moss, University of Florida, whose academic 'holy grail' is to develop models that provide a complete understanding of the factors that affect farmland values. The paper starts with an overview on the economic theory aspects highlighting the Ricardo and von Thunen concepts of farmland valuation, along with the finance theory and practical examples. The paper then discusses the effects of government policy, macroeconomic pressures, urban sprawl and speculation on the value of farmland. Taking all these factors into consideration, the author is only able to account for relatively modest variations in farmland values, that do not reflect the actual changes observed in farmland markets worldwide. The fact that Professor Moss is still pursuing his holy grail highlights that the factors that impact on farmland valuation are enormously complex and currently defy modelling and economic theory.

The fourth paper, contributed by Professor Chris Eves, analyses NSW rural property investment returns over the 24-year period from 1990 to 2014. The paper begins with a discussion of trends in rural land ownership in Australia and changes that have occurred in recent times. It analyses trends in ownership of farmland by foreign corporates and institutions, noting that this does not appear to have resulted in increased land prices across all rural property (noting this is limited to NSW). Professor Eves has reviewed data from over 40,000 sales transactions (of properties with an area greater than 40 hectares), undertaking analysis of both capital gains and operating returns for the main categories of farmland uses. While the seasonality of production is reflected in both operating and capital returns, there does appear to have been a significant slowing in the rate of capital growth in most regions over the past three years (2012–14).

The fifth paper by Dr Wendong Zhang and Zachariah Beek delves into the trends and determinants of United States (US) farmland values since 1910, using evidence from the annual Iowa Land Value Survey. The aggregate value of farm real estate in the US is estimated to be US$2.31 trillion, equivalent to 85% of total US farm assets. Analysing the large amount of data collected on Iowa land over decades, the authors identify three major 'golden eras' in US modern agriculture, when rapidly increasing farmland values, high farm commodity prices, and very strong farm income all coincided. As part of the analysis, the authors compare an investment in the stock market with investment in farmland, finding that farmland has delivered better returns on average over the past 50 years, although as always this finding is dependent on the timing of the investment and the sale of the asset.

Several quite important observations are evident from the above papers. Firstly, farmland generally displays long-term rates of capital appreciation that are well in excess of inflation rates, although the extent of that capital growth for an individual investor depends very much on the timing of entry and exit.

Secondly, the value of farmland appears to be generally well in excess of what would normally be considered to represent a value that returned 'normal' returns from an investment in other asset classes. This apparent overvaluation of farmland appears to be driven partly by the fact that farm operating returns are very dependent on management skills, and therefore land values are effectively set by the returns available to the most skilled managers, rather than the average managers.

A quote from Warren Buffet sums up the valuation of land quite well, 'Price is what you pay. Value is what you get.' Time will tell if the current investors in Australian farmland will be able to achieve good returns for the prices they are paying, but unless they are able to secure highly skilled management teams, the answer will almost definitely be no.

Mick Keogh