Farmland: The New Gold?

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Yes, it's just 'dirt', but life on this planet wouldn't exist as it does today unless it didn't comprise a third of the world's surface. Unfortunately much of that 'dirt' is in areas too wet, dry, rocky, salty, devoid of nutrients, or covered by snow for agricultural production.

With only 14 percent of the world's landmass considered fertile, and that shrinking at a significant pace, there's a realization that increased farm production is essential to satisfy the increasing demand for food products. What's more, world arable land per person has been declining for more than five decades, as a result of a variety of natural and man-made factors.

Factors contributing to the need for enhanced agricultural productivity

In 1960, the world population stood at three billion and constituted a ratio of 12 acres of farmland per capita. Now, with a world population that is closing in on seven billion people (and growing at a pace of 211,000 per day), the world ratio has fallen to 1.5 acres. At current levels of productivity, it's estimated that 1.2 acres of farmland per person is required for a minimum level of nutrition. Obviously, the declining arable land, combined with a massive global population expansion, has intensified the stress to find enhancements to agricultural productivity.

Additionally, the *CIA Factbook* estimates that world population is expected to grow to more than nine billion people by 2050. Much of that growth is anticipated to occur in the 'emerging' nations, which also are expected to experience the greatest levels of urban immigration. Consistent with urbanization is a reduction of farmland—and the human infrastructure to work the fields.

Without going into the statistics that indicate an improving financial status of many developing nations, the world's growing middle class, the migration of rural population in Asia to an urban culture and, at the same time, a destabilization of agriculture production, due to deforestation, erosion, salt contamination, drought and urbanization, will all create an obvious need for expansion in agriculture productivity.

Likewise, the divergence of agricultural products into bio-fuels also will create more pressure for agricultural productivity expansion. This will be the result of increases in energy prices, which will accompany deepening worldwide demand, in concert with growing concerns over conflicts surrounding supply expectations.

Agricultural productivity will need greater increases in the future to meet demand

That is not to say there hasn't been significant productivity expansion already. In fact, through advances in agricultural thinking, agricultural output indeed has been subject to increased productivity in the United States. From 1948 to 2009, U.S. farm output in 2009 was 170 percent above its level in 1948, increasing at an average annual rate of 1.63 percent rate, according to the USDA's Economic Research Service (ERS).

But, in October 2010, at the World Food Prize Symposium in Iowa, the ERS, along with the Farm Foundation and the Global Harvest Initiative (GHI), noted in a 2010 GAP Report that productivity growth is lagging the world's ever-growing demands. The USDA postulated that to close the production-to-need gap, the rate of productivity growth must average 25 percent more per year over the next 40 years. Therefore, whatever scientific breakthroughs that may occur to aid agricultural efficiency, the worldwide demands are likely to supersede short-term productivity enhancements.

However, as we have seen with the dire projections of Thomas Robert Malthus, David Ricardo, and other economists who extrapolate the future based upon historical trends, the current situation is serious, but probably not calamitous. Indeed, as reported by Morgan Stanley, a study conducted for the New York City Council correctly predicted the rising standards of living in the nineteenth century, and the huge population growth the city would experience as a result. Study experts, unfortunately, also extrapolated that it would require 100,000 men to remove horse manure from the city's streets—a by-product of the only means of transportation then contemplated.

Quite simply, there's usually a failure to recognize advances in science that may overcome socio-economic problems. As money manager and author of *Wealth, War and Wisdom*, Barton Biggs, once noted, "The doomsayers work by extrapolation; they take a trend and extend it, forgetting that the doom factor, sooner or later, generates a coping mechanism. You cannot extrapolate any series in which the human element intrudes; history, that is, the human narrative, never follows, and will always fool, the scientific curve."

Investor interest will mount as prices for agricultural land rise

As Consumer Price Index (CPI) statistics are ultimately elevated, wage and price spirals are likely to accelerate investor interest in tangible assets and commodities, like agricultural land. Certainly, we have already experienced a significant move in farmland prices in the U.S. It's important to note, however, that, while there has been increasing investor interest in agricultural land, existing farmers have represented the majority of farmland acquisition.

Consequently, it's no surprise that U.S. farmland prices have been on the upswing. In looking at the statistics, the investment community is starting to recognize the potential supply-demand imbalance—and the growing importance of the agriculture economy. Some say this price expansion is creating a bubble in the farm belt (prices of Iowa farmland increased 32.5 percent in the past year alone to a record $6,708 per acre). At a current production rate of 165 bushels of corn per acre, and the recent price of $6.66 per bushel, there's still a considerable investment payback period. Nevertheless, the combination of the attractiveness of a tangible asset, together with a cash flow to provide financing coverage, is a tempting alternative to other tangible and financial investments.

In keeping with this trend, it would be a mistake to overlook the significant increasing wealth of farmers—and the economic impact of their discretionary income. In the U.S., farm income increased 28 percent in each of 2010 and 2011. This was in a period where general consumer income rose 4.3 percent in 2011 (per capita personal income), and 2.8 percent in 2010.

The increasing discretionary income to farmers and ranchers is becoming an important economic factor. This income flow is further enhanced by the rapid growth of shale oil production through fracking procedures in many of the rural farmland regions. Therefore, it's expected that farmers can continue to expand farm acreage and equipment purchases as in the past. Because of this, a greater level of consumer discretionary purchases in rural locations may also be expected. This may result in a significant source of demand for companies such as, Family Dollar, Dollar General, Gander Mountain, Flowserve Corporation, Terra Nitrogen Company, Lindsay Corporation, Watts Water Technologies, Inc., and Cabela's, companies that cater to a rural environment.

Scarce agricultural land as a tangible investment alternative to paper currencies

The above factors will catch the eye of increasing numbers of investors, who seek exposure to tangible assets like agricultural land, as a way to make money and counter possible future inflation trends, created by the vast expanse in the monetary base in the U.S. and most European nations.

The traditional response to inflation, through investing in gold and precious metals, has propelled those strategies to all-time high levels. Additionally, both non-precious hard, and soft, commodities also have experienced some degree of investor enthusiasm as anti-currency alternatives. Mind that these market movements are in anticipation of inflation levels that have not occurred as of yet.

In addition to countering inflation, one might also postulate that the spectacular rise in the price of gold, and other hard commodities, could be based on the fear that they are an alternative to vastly expanded paper currencies in the world. The attractiveness of gold as a storehouse of value has pushed its price over $1,400 per ounce. Yet gold is a non-productive asset, whose value is solely derived from its scarcity.

Alternatively, prime, productive acreage is not only scarce—and shrinking—but also has the ability to create current income for its holders. Therefore, farmland offers a tangible alternative to paper currencies (as does gold). But, while most recognize gold has value because of its scarcity, fewer recognize that agricultural land is now becoming scarcer, and, as a result, is also greatly rising in value. This scarcity is becoming realized in the markets, along with the recognition that there is significant generation of current cash income from crop demand, which gold does not offer.

Moreover, while traditionally the realm of large institutional investors, farm and timber land parcels are now being packaged like Real Estate Investment Trusts (REIT's) and Exchange-Traded Funds (ETF's), to be delivered to smaller investors. Furthermore, in addition to land, investments in companies that *produce* agricultural equipment, fertilizers, irrigation equipment, water flow controls, bulk transportation, pesticides, seeds, and managed feedlots are finding increasing investor interest.

Many alternative paths to investor success in agriculture

As of yet, it's been difficult for the average investor to directly invest in diversified farmland. However, it's likely that Wall Street will find an avenue for investment directly into farm acreage, just as the REIT industry has with other forms of land and commercial real estate investment. Current, traditional investment thinking has resulted in a grid of ten major economic sectors: consumer discretionary, consumer staples, technology, energy, utilities, healthcare, industrial, materials, telecommunication, and financials. Perhaps, eventually, agriculture will rate its own important sector in the world of investing as liquidity, legitimacy, capital, and understanding follow its uptrend.

Nonetheless, growing investor interest in the agribusiness picture will undoubtedly create a variety of alternative ways for investors, who seek exposure to base soft commodities and targeted agricultural products and agribusiness, to participate in expanding agricultural related opportunities. Some of these alternatives are already present and can be found in ETFs, individual stocks, and outright land purchases.

With George Soros, and a number of other large investors, snapping up available farmland, it's inevitable that the investment industry will develop a capability of raw land investment participation. Until that point, agribusiness will continue to expand in investor sentiment, and the potential of agriculture as an industry may once again supersede manufacturing as an economic force in the United States.

Ultimately, for the future, we are entering a period of time when agricultural land will become as sought after, and as, if not more, valuable than gold.

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