



Understanding Farmland REITs

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The pronounced growth in farm real estate values over the last decade has significantly increased the interest in farm real estate as an investment and led to the development of new investment vehicles dedicated to farm real estate. This article explains some of the key features of one class of new farm real estate investment vehicles, publicly listed farmland real estate investment trusts (REITs).

REITs are investments that hold various types of real estate and allow shareholders to share in the returns generated from those properties, in the form of profits or losses. Legislation authorizing REITs was signed into law in 1960, and the first one was listed on the New York Stock Exchange in 1965. Sometimes described as "mutual funds that hold real estate," there are strict rules governing how REITs make investments and distribute earnings. At least 75% of the assets must be invested in real estate or cash (including US Treasury securities), at least 75% of the income must be derived from real estate sources, and at least 90% of the annual income must be distributed to shareholders as dividends.

REITs therefore offer exposure to real estate assets without the high transaction and management costs associated with direct purchases. Further, it is possible to purchase in smaller and more liquid allocations. That is, instead of buying an entire property worth thousands or millions of dollars, REIT investors can purchase just a few shares that are bought and sold easily on public exchanges. REITs are often promoted based on their portfolio diversification benefits as their returns typically have low correlation with traditional equities.

Types of REITs

There is a vast number of REITs. For example, as of September 30, 2015, there were 199 REITs listed on the New York Stock Exchange alone ([National Association of Real Estate Investment Trusts](#)). There are two general types of REITs. Equity REITs hold various properties, lease these properties and collect rent from tenants. Additional income may come from capital gains on the sale of properties. At the end of 2014, the combined value of outstanding shares for all US equity REITs was \$907 billion. The other type are mortgage REITs, which buy existing mortgages or provide new financing, and earn income from the interest payments on these investments. Additional income may come from capital gains on the sale of these mortgages. At the end of 2014, the combined value of outstanding shares for all US mortgage REITs was

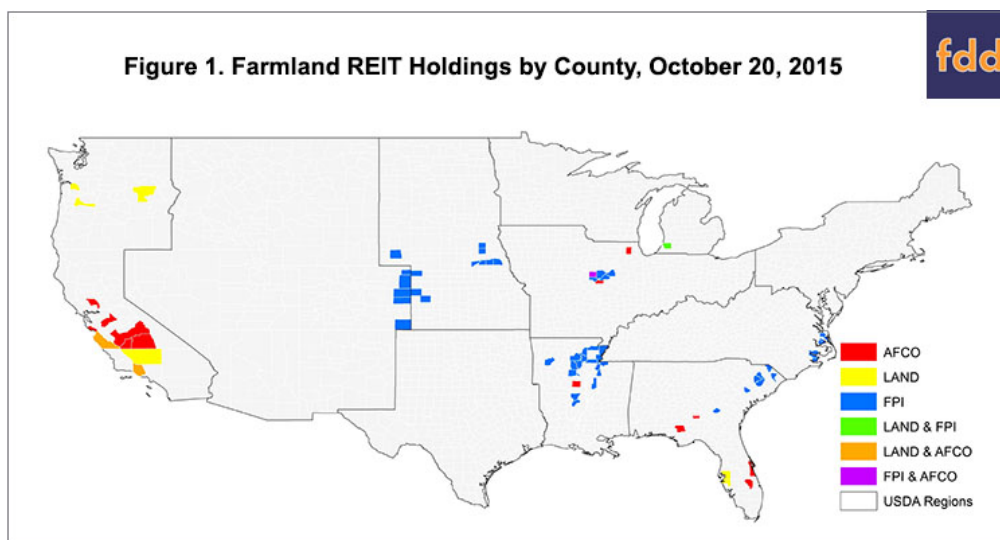
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\$846 billion. For both equity REITs and mortgage REITs, the dividend distributions are designed to represent the returns that investors would receive if they owned the properties directly.

REITs typically specialize in a particular type of property, such as apartment buildings, shopping malls, office buildings, or warehouses. Farmland REITs are a relatively recent development, with just three funds so far: Gladstone Land (NASDAQ ticker symbol LAND), Farmland Partners (NYSE ticker symbol FPI), and American Farmland Company (NYSE ticker symbol AFCO). The three funds differ in their composition of properties, but they began with similar values of initial outstanding shares. LAND began trading on January 29, 2013 with total shares initially valued at \$50 million. FPI began trading on April 16, 2014 with total shares initially valued at \$53.2 million, and AFCO began trading on October 20, 2015 with total shares initially valued at \$48 million.

Portfolios of Farmland REITs

The three farmland REITs have taken different approaches to the types and locations of farmland they own. The geographic footprint of the three funds, as of October 20, 2015, is shown in Figure 1. LAND began with fruit, vegetable, and berry operations concentrated in California and Florida. It has since expanded into other states and issued additional shares. FPI began with properties in the central and southeastern US that are used to grow primary crops such as corn, soybeans, wheat, rice and cotton. It likewise has expanded and has issued additional shares. AFCO's acreage is roughly one-third grapes, nuts, and specialty crops; one-third primary crops including corn and soybeans; and one-third farmland that is targeted for future development.

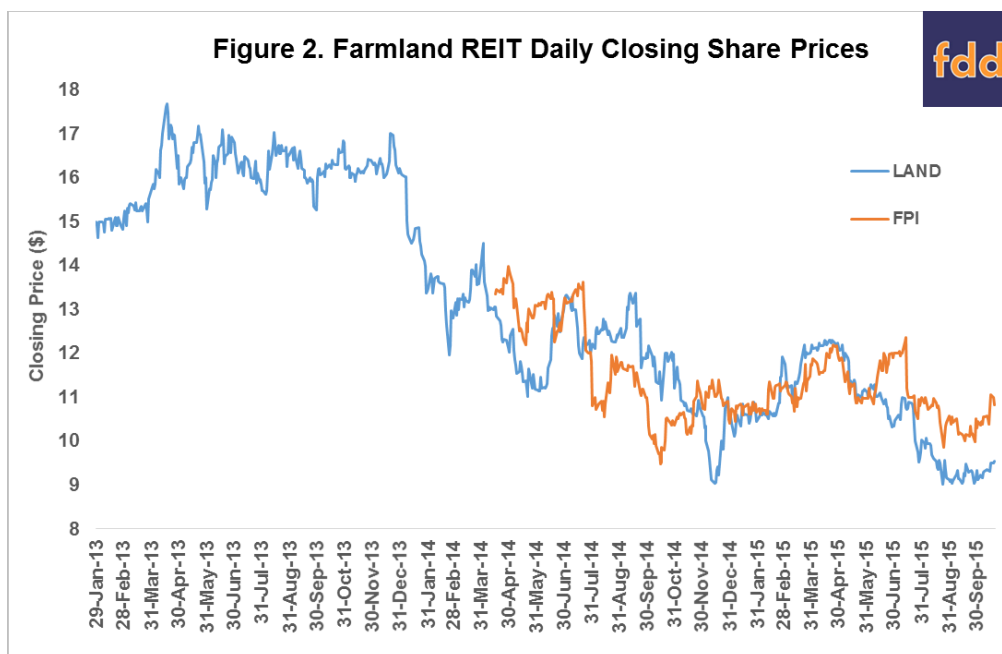


Farmland REIT Price Histories

All three funds are equity REITs that own farmland and lease it to farmers. Consequently, fund values should reflect changes farm returns or farmland rental rates to a greater extent than aggregate land prices. Despite the different approaches to farmland investment, all three farmland REITs have seen their share prices decline from the time of initial public offering. On October 20, 2015 AFCO set its initial public offering at \$8.00, but the price fell by \$1.07 to \$6.93 at close in its first day of trading (a 13.38% reduction). For comparison, the major stock indexes on October 20 fell by 0.1%, LAND share prices rose by 0.53%, and FPI share prices fell by 1.9%.

The longer price histories for LAND and FPI also demonstrate a declining share price between initial public offering and October 20, 2015 (Figure 2). LAND closed at \$9.53 per share on October 20 vs. \$15.00 at the

time of its initial public offering, and FPI closed at \$10.83 per share on October 20 vs. \$14.00 at the time of its initial public offering.



Outlook

Even after adjusting for dividends, share repurchases, and other factors, it has been a bumpy ride for investors in all three farmland funds. Earlier in this article we noted that farmland REIT values are expected to reflect rental rates, as opposed to farmland prices. The stock market is forward-looking, and stock prices represent the discounted value of expected future returns. The declines in the share prices of all three farmland REITs suggest that future returns were overestimated when each fund was first publicly listed. The REIT price trends reflect lower expected future returns, consistent with the lower cash rents described in recent articles (*farmdoc daily* September 22, 2015; October 20, 2015).

Disclaimer: None of the information contained in this article should be considered investment advice, and readers should not base investment decisions based on any of the information presented here.

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