Commentary

Why Are There Not More Farmland REITs in Australia?

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REITs are a highly regulated but tax-efficient method for investors to hold real estate. They are permitted to hold farmland as well as residential and commercial property and other real estate assets, including farmland F-REITs. However, despite the importance of agriculture for Australia and the size of Australian farmland there has only ever been one F-REIT, Rural Funds Group (ASX - RFF). The explanation lies in a combination of factors, including the availability of alternative investment vehicles, barriers to entry including capital market constraints and limited quantities of suitable farmland available for sale and a decline in investor interest in REITs overall. As a result, RFF is likely to continue to enjoy its unique offering to investors.

Introduction

What are farmland REITs?

REITs in general are tax-exempt 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. They were first introduced in the USA in 1961. Australia was only the second country to follow suit ten years later with Limited Property Trusts, now Australian REIT. By contrast, concerns over the impact on tax revenue led to the UK only introducing them as late as 2007. REITs legislation varies internationally, with private as well as public REITs permitted in all three countries: in Australia, those listed are regulated by the Australian Securities Exchange (ASX and ASIC). By comparison to the US and UK regulations regarding asset concentration on real estate, a minimum of 75%, and the more stringent 90% that applies in New Zealand, Australian REITs regulation is exceptional in not having any such restrictions on investments, successfully relying on investor priorities and choices to

generate focus. Australian regulations requiring the distribution of 100% of net ncome as dividends, however, are even more restrictive than the 90% that applies in the USA, UK and New Zealand[1].

One potential area of investment for REITs is farmland. Between 2017 and 2022, the compound annualized growth rate (CAGR) of the value of US farmland was 4.6 percent, with a further 7.4% increase in 2023[2]. Over a much longer period, 1970-2022, total farmland returns (i.e., including land rent as well as capital value growth) exceeded the CPI by 6.2%[3]. To put that return into perspective, it outperformed all other asset classes except the Dow Jones REIT Index during that time frame. In Australia, the ANREV farmland index has over the long term demonstrated a similar set of attractive returns, with returns recovering in 2024 from a relatively fallow period over the last few years. However, in addition to the above-average total return potential of owning farmland over the long-term, it provides investors with several other benefits, including lower volatility than most other asset classes, low correlation with equities as a whole and correlation with inflation through the commodities output of farmland. Some have described farmland 'a gold-like investment with a yield'[4].

Given the potential attractiveness of farmland REITs, their almost complete absence amongst listed REITs is surprising. In the USA out of 190+ listed REITs in 2024 there are only two[5]. In the UK, out of 50+, none[6]; two announced plans to list but withdrew them amidst post-Covid market volatility. In Australia, a country with one of the most highly developed agricultural production sectors in the world out of 42 listed REITs as of October 2024[7], there is only one farmland REIT. This despite the fact that Australia, along with North America and New Zealand, is one of the key jurisdictions of the international farmland 'investable universe'[8] This is a puzzle which deserves to be solved.

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Name	Jurisdiction	Operations	Market Capitalisation	URL
Farmland LP	USA	Organically enriched soil	Private REIT	https://www.farmlandlp.com/
Farmland Partners Inc	USA	Almost 300 farms, 155,000 acres	US$549m	https://www.farmlandpartners.com/
Gladstone Land Corporation	USA	169 farms, 116,000 acres – mainly fresh produce	US$498m	https://www.gladstonefarms.com/
Global Sustainable Farmland Income Trust	UK	n/a	Private – Flotation cancelled	n/a
Iroquois Valley Farmland	USA	70+ farms, 35,000 acres, organic produce	Private REIT	https://iroquoisvalley.com/
New Zealand Rural Land Co	USA	8 tenants, 43,137 acres	NZ$124.9m (US$74.7m)	https://www.nzrlc.co.nz/
Rural Funds Management	Australia	1,831,000 acres	A$743m (US$497m)	https://www.ruralfunds.com.au/

Table 1. Selected F-REITs: international comparison

Why should this matter?

From an investor perspective, agricultural REITs have been held to be an important component of a diversified portfolio.[9]. They are also regarded as an attractive route towards farmland ownership, in some cases the only route. Advisers argue that they have generated attractive, stable long-term total returns that serve as an inflation hedge through a combination of land value appreciation and the

rents paid by farming tenants. ‘These characteristics make farmland a superb way for investors to diversify their portfolios’[10]. Yet the farming sector remains a non-traditional asset category for most investors, largely because farmers, both operators and retirees, own the majority of the country's cropland and pastureland.

In the Australian case these criticisms are even wider off the mark. The extent to which REITs have been owned by superannuation funds is a strong indication of their contribution to the democratisation of key assets, including potentially farmland. The existence of only one agricultural REIT is therefore potentially a matter of concern.

Background to the study of F-REITs

Studies on REITs worldwide are familiar and frequent. Most academic studies however focus on the performance of REITs as an investment class in particular markets, For those few that do focus on a case study of an individual REIT, the aim has been to elucidate business and tax arrangements[11], risk and return[12], valuation[13], performance correlation with macro indicators[14] or investment decision-making[15]. By contrast, studies on the market positioning of REITs or their comparative advantages are scarce. An exception has been the study of Iroquois Valley Farmland REIT, which focused on the use of the Public Benefit Corporation structure to effect sustainable development on behalf of stakeholders[16].

Studying Rural Funds Management (RFF)

As there is only one Australian agricultural REIT, the approach taken has been to investigate RFF in depth as a case study first, and then to use the evidence gleaned to derive conclusions as to why it remains unique in Australia. A leading definition of a case study has been ‘an empirical inquiry that investigates a contemporary phenomenon (“the case”) in depth and within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident’[17] Case study research has been used in many settings, from economics, education, medicine, political science, psychology, social science and sociology[18]. The combination of documents and interviews has always been at the heart of case study research; engagement with RFF was therefore a series of interviews and questionnaires with its management as well as analysts together with an examination

of Annual Reports and other company documents and commentaries from analysts on its performance.

The listed entity itself is a stapled REIT combining the Rural Funds Trust and RF Active. The leading Australian financial journal has a web page devoted to it,[19] as do two leading international investor websites[10]. RFF is a lessor of agricultural property. Its revenue is derived from leasing almond orchards, macadamia orchards, vineyards, cattle properties, cropping properties, agricultural plant and equipment, cattle and water rights. RFF also carries out farming operations on an interim basis for unleased properties and properties under development. It has a clear and consistent strategy: to generate capital growth and income from developing and leasing agricultural assets. This is accompanied by a series of financial targets. It has a distribution target of 4% and for gearing, 30-35% [20]compared to actual figures as of mid-2024 of 5.6%[20] and 45.6%, still well within its 55% covenant[20], and even lower at the end of the financial year at 37.3%[21]. RFF also aims to maintain a majority of long Weighted Average Lease Expiry (WALE) triple net leases: as of mid-2024 its WALE stood at 13.5 years[22]. This is a remarkably similar figure to its peer across the water at 12.7 years[23]. RFF aims not only to lease its agricultural land but to seek improved productivity or changes in use in accordance with Highest-and-Best-Use (HBU) principles through a policy of active engagement as well as a comprehensive ESG strategy[22]. RFF is also committed to expansion through acquisitions: in the financial year 2022-23 it acquired farms worth $102.1m.[24]. Information online about RFF is plentiful.

Rural Funds Management (RFM) is the management company for the group. The number of people working either directly or indirectly with RFF is large, in excess of 250 people. Many of these individuals are in-house sectoral specialists, whether in individual crops or livestock, or plant and equipment. But in its engagement with existing and potential lessees RFM draws on their sectoral experience, understanding of relevant operating metrics and ability to 'speak the language' used by existing and potential lessees. This team of experts is complemented by a senior management team that is conspicuous for its low turnover.

Result and Discussion

What explanation is there for the uniqueness of RFF? Case studies often end with conclusions formed by the researcher about the overall meaning derived from the case(s[17]). In the RFF case, the principal

conclusion is that the combination of size, expertise and now considerable history as a listed F-REIT results in significant barrier to entry for any potential competitor. Just assembling the volume of farmland RFF owns would take a considerable time and whereas in the UK at least, it was reported that the volume of farm sales has been steadily increasing such that in January 2024 there were 213 farms on offer, ranging from 50 to 500+ acres[25], it is not even clear that such a volume of land or anywhere near it is on offer in Australia at any one time. AFR land sales Mondays. It should also be recognised that IPOs are expensive and not always guaranteed to succeed, as the two examples of failed F-REITs from the UK demonstrate. Outside the case itself, however, there are other factors that militate against a proliferation of Australian F-REITs.

The first and most significant constraint on the growth of F-REITs is the plentiful availability of alternatives.

a. Direct investment is one alternative. The most obvious way to invest in farmland is to directly purchase already usable arable or pasture farmland. As an investor will most likely not want to farm themselves, this clearly entails finding a farm tenant, which may be a time-consuming exercise if the land is not already tenanted. Existing local farmers may wish to extend their operations in by leasing additional land, but the requirement of effective due diligence is very clear if this route is to be followed, so a local agent may well be necessary. A more specific application of the same approach is to buy an existing farm in its entirety and then lease it back to its current owner. This may work well for a distressed asset, but the number of such opportunities is small and carries the risk that the tenant may either default or at least end their tenancy at some future point. Throughout, there may be a risk that the investor is paying over-the-odds as a result of a lack of local knowledge and connections. A similar governance risk and potentially long timeframe may apply. Advisers are quick to point out all the potential obstacles to each of these routes[4].

Whichever way it is undertaken, however, direct investment into farmland involves significant upfront costs. The high upfront costs of buying farmland have traditionally been an obstacle for investors. United States cropland value averaged $5,570 per acre in mid-2024, an increase of $250 per acre (4.7%) from the previous year. Pasture value averaged $1,830 per acre, an increase of $90 per acre (5.2%) from 2023. In Australia, farmland in the first half of 2024 reached a median value in the first

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half of 2024 of A$10,141/ha, up 12.2% compared to a year earlier[26]. This is obvious competition for any F-REIT.

b. Crowdfunding is another alternative, especially in the USA. Here, the upfront costs are much lower. Platforms such as AcreTrader, FarmFundr, Farm Together, the feeder funds of Farmland LP, Harvest Returns and Steward are some of the most well-known US examples. However, most farmland crowdfunding platforms are only open to HNWI accredited investors. Many are also organised as indirect investments, i.e., instead of holding the legal title to the land, investors own shares in a limited liability corporation (LLC) that then holds legal title.
c. International investment in farmland is also presented with alternatives to F-REITs in the form of joint ventures and direct investments. iShares Global Agriculture Index. Gresham House Forestry Fund and Acre Impact Capital are examples in the UK, although despite several attempts in the past there are as of 2024 no surviving investment trusts for farmland. However these funds are, like crowdfunding, also illiquid and do also require larger investment sizes than a listed REIT.
d. Finally, it is noticeable that at least one investor website considers other REITs to be competitors, either choosing or not noticing the huge differences between RFF and the others cited in areas such as hospitality, healthcare and storage[27].

Secondly, then, an F-REIT must be a more attractive investment than these alternatives in terms of some kind of combination of risk and return. Yet any F-REIT can only achieve some measure of performance beyond the land prices to which it is effectively tied. A comparison between actual farmland prices and the RFF share price is therefore useful. The ANREV farmland capital value index has until the last two years shown steady growth:

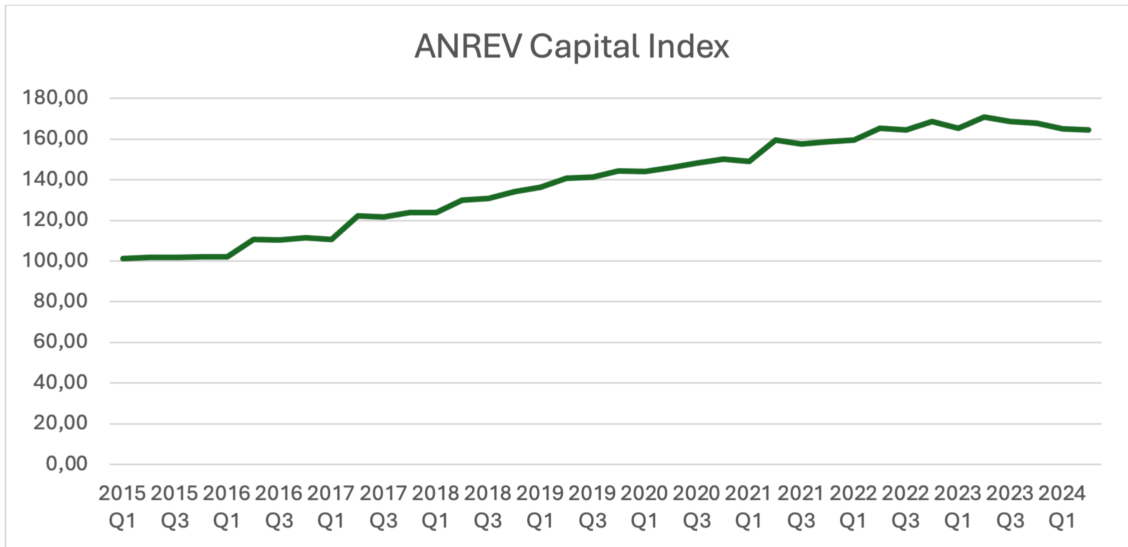

Figure 1. Land price appreciation in Australia, 2015-2024

By comparison, after rapid appreciation earlier in the decade, the RFF share price has now returned to the level of mid-2017. Comparing values 2015 to now, however, does show significant outperformance compared to the ANREV Capital Index.

Figure 2. RFF Share Price, 2015-2024

Source: Yahoo Finance Rural Funds Group (RFF.AX) (2024)

Growth of Net Asset Value (NAV) is also instructive. In December 2013, NAV per unit stood at A$1.01[28]. By June 2024 this had more than trebled to A$3.14 per unit. Whatever any new market entrant might envisage, it is evident that merely holding a representative selection of Australian farmland will not suffice to provide effective competition to RFF.

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Thirdly, there may be historical reasons why RFF remains without direct listed competitors. REITs have in the past been considered reliable, relatively high-yielding investments with moderate growth potential. Agriculture is not necessarily an entirely good fit for this overall REITs positioning given the operational volatility in many agricultural sectors and the tendency of capital growth via land price appreciation to dominate a good portion of the return. Perhaps even more importantly, REITs have since at least the Global Financial Crisis lost some of their initial allure, partly because of a reduction in the rate of land price appreciation in Australia and elsewhere, partly in more recent years because of interest rate rises and other threats to established real estate asset classes (Broker 1).

In a sense therefore potential competitors to RFF may have simply left it too late to stage F-REIT IPOs. In the USA, the picture is very similar to Australia. If the share price spike for both F-REITs in the period between 2021 and 2023 did not encourage F-REIT IPOs, then it is difficult to envisage how their subsequent trajectory would do so.

Gladstone Land Corporation share price history

Farmland Partners share price history

Source: Trading View (2024)

Figure 3. US F-REIT share prices 2015-2024

Fourthly, there may therefore be some plausibility in a resource-based explanation. RFM is well-staffed with over 250 full and part-time employees. As a result, RFM can deploy sector-specific experts with actual farming experience to discuss farm leases with potential farming tenants.

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Competing with this level of resourcing would evidently not be easy. RFM has for example been innovative is in the lease structures it has signed with tenants, which strike a relatively attractive yield but also help the tenant in terms of financing capex for which the tenant and landlord share in the upside. This may be difficult for any potential competitor to replicate. A linked explanation is first mover advantage: in Australia land ownership is also highly fragmented, rendering the assembly process prior to an IPO potentially long and potentially difficult at a time when the market is less sympathetic to REITs overall than it was earlier in the century.

Finally, F-REITs also have some very limited disadvantages that might deter investors who trust their own judgement, as F-REIT management choose the farming tenants, not the investors[29]. Perhaps more importantly, listed F-REITs trade on stock exchanges and These farmland investment opportunities are influenced by broader market dynamics. In the USA, they have exhibited historically higher volatility than direct farmland investments as represented by the NCREIF Farmland Index[30]. F-REITs therefore do have some market as well as land price risk that they acquire in exchange for liquidity. Also, from a taxation standpoint, REITs are treated as normal income for taxation purposes and not capital gains. Subsequently, they attract higher taxes than some listed funds.

Conclusions

The effect of more F-REITs would be to open up the possibility of further international investment into Australian farmland. Given political concerns over existing levels, policymakers may be averse to encouraging further F-REITs. Arguably equally important, however, is the social perspective overall. Here the argument has been the supposed contribution of F-REITs to a global 'land grab'[31]. But this is surely misplaced criticism at least so far as F-REITs in developed countries are concerned: as investments open to pension funds they represent an opportunity to broaden land ownership not narrow it.

Yet the puzzle of why Australia has so much farmland, but only one listed F-REIT, turns out to be soluble through an explanation that works at both the internal level of RFM itself and the external level of competition and competitive environment. The obstacles to the creation of more F-REITs in Australia are revealed as both significant and difficult to overcome. As it is evident that without intervention the market will not create competitors to RFF, if this was deemed desirable it would be necessary to introduce incentives at several levels. These would have to include encouragements for farmers to sell and funds to invest, potentially through tax breaks both prior and subsequent to IPO,

and even access to government funding through grants or subsidized loans. Anything short of such substantial steps would be unlikely to succeed. Given the market distortions that such measures would undoubtedly introduce, it would appear unlikely that any Government would believe that the balance of policy desirability would ever lean in the direction of such measures. So whilst such changes remain possible, in their absence RFF is therefore likely to continue to enjoy its solitary status.

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