OPINION

Four reasons why wealthy investors should hold farmland in their portfolios

ANDREA GRUZA
THE GLOBE AND MAIL
PUBLISHED 5 HOURS AGO

0 COMMENTS SHARE A A+ TEXT SIZE BOOKMARK

An investment in Canadian farmland can hedge against the negative impacts associated with climate change on investors' portfolios.

KEVIN MILLER/ISTOCKPHOTO / GETTY IMAGES

Reports published earlier this year of Bill and Melinda Gates being the largest private owners of farmland in the U.S., along with Warren Buffet promoting farms as wealth-producing assets in his annual letter to Berkshire Hathaway Inc. shareholders is leading many high-net-worth (HNW) investors to ask whether they should be investing in farmland as well.

For many, the idea of farmland as an investible asset class is a new and novel concept, but many sophisticated institutional and HNW investors have been invested in farmland for years.

Every investor is unique, and farmland may not be the right holding for every person. Yet, an awareness of this asset class and its various benefits is useful for financial advisors focused on providing a full suite of options to their clients to maximize the performance of their portfolios.

As such, there are four key reasons why wealthy investors should consider holding Canadian farmland in their portfolios:

1. Farmland offers diversified, risk-adjusted returns

Everyone needs to eat. That's a simple fact, but it speaks to the importance of farmland in supporting increasing global demand for food. With a limited supply of quality, arable farmland, investors anticipate continued, stable long-term capital appreciation from this asset class. Historically, Canadian farmland appreciated at an average annual rate of 7 per cent between 1950 and 2020, with only six years of year-over-year declines.

Investors look to farmland as a safe-haven investment with a low correlation to traditional equities and fixed-income markets. The addition of farmland to a portfolio can help smooth returns and provide downside protection in times of market volatility. According to recent research from Toronto-based Bonnefield Financial Inc.*, the addition of Canadian farmland to a portfolio can result in higher potential returns per unit of risk taken.

Specifically, diversified farmland exposure of at least 70 per cent has the potential to increase a portfolio's Sharpe ratio to more than 1.0, which means the potential return exceeds risk, compared with only 0.43 with a portfolio of 100 per cent in equities.

2. Farmland historically performs well in periods of inflation

The massive stimulus packages that central banks and governments introduced in response to the economic disruption caused by the COVID-19 pandemic have led many to believe that a period of high inflation is inevitable. As a result, investors are looking for ways to hedge against the impact of inflation and protect the value of their assets.

Farmland offers an attractive option to hedge for inflation based on its historical performance. In Canada and the U.S., the value of farmland values has generated relatively higher returns during periods of high inflation than during periods of low inflation.

Grant Wilson, a lecturer with the department of management and marketing at the University of Saskatchewan's Edwards School of Business, recently compared inflation to Canadian farmland appreciation from 2000 to 2020. According to his analysis, cumulative inflation in Canada was 39 per cent while cumulative appreciation in the value of farmland was 168 per cent.

3. Canadian farmland can hedge climate change impacts in a portfolio

The concepts of portfolio resilience to risk and value preservation are critical to HNW investors. Climate change, with its associated large-scale weather events and changing regulatory environment, has created uncertainty and pressure on many industries around the world, with the prospect of eroded returns. An investment in Canadian farmland can hedge against these negative impacts.

In Canada, longer growing seasons, increased heat units, and changing crop genetics have the potential to increase the productivity of farmland. In both core growing regions as well as more peripheral, northern agricultural areas, the potential to grow higher-value crops is a unique relative benefit of changing climatic conditions. Moreover, farmland in the U.S, Australia, and South America is facing threats from wildfires, water depletion, and drought that take supply off the market, thus creating an opportunity for a more favourable commodity pricing environment. For these reasons, Canadian farmland can add long-term resilience to an investment portfolio.

4. Canadian farmland has attractive ESG characteristics.

Increasingly, HNW investors want to ensure their money is being invested in industries that are in line with their values. Canadian farmland is a compelling asset class for investors looking to track the environmental, social, and governance (ESG) characteristics of their investments because it has a natural set of value drivers that align with an ESG framework.

The fact that the long-term productive capacity of farmland is dependant on having the necessary environmental conditions to support crop growth (i.e. ongoing access to freshwater) highlights the natural relationship with the "E" in ESG.

From a social perspective, various investment models can serve to support Canadian farmers as they grow their long-term operations. Investment capital can be used to fund enhancements to the land, improving its productive capacity and long-term sustainability.

As a result, farm operators benefit from access to more attractive acres, while investors drive returns with their investments in tangible improvements to the land. The ability to achieve long-term, stable returns while supporting the Canadian agricultural community offers significant appeal to many investors.

Finally, with appropriate management and operating practices, Canadian farmland has been shown to act as a net carbon sink, meaning it removes more carbon from the atmosphere than it emits. By supporting sustainable farmland practices, investors can be part of the solution to reduce net emissions over time.

Andrea Gruza is vice-president, capital markets, at Bonnefield Financial Inc. in Toronto.

© Copyright 2021 The Globe and Mail Inc. All rights reserved.

351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher