Chapter 4

Considerations in Dealing with Farmland Investors

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Increasing numbers of investors are taking serious interest in purchasing farmland as an investment. There are at least three fundamental reasons:

1. Land values continue to trend upwards.
2. Returns from stocks and other investments seem increasingly unpredictable.
3. Land is a tangible asset, and historically it has been a hedge against inflation.

The Midwest has seen a recent explosion of interest and speculation from investors. Rental rates and revenues from larger annual commodity crop plantings are easier to predict in the midwest relative to other regions. Although the movement has not yet spread beyond the Midwest in noticeable proportions, many analysts predict that farmland investing is on the horizon in the Northeast. The potential opportunity is to channel private investment into farmland and open space preservation, buffering suburban sprawl and keeping farmers at work. The potential drawback is that land is still controlled by “those who do not work it and worked by those who do not own it.”

Annette Higby points out in “The Legal Guide to the Business of Farming in Vermont”:

*This land tenure pattern—which is even more extreme in other parts of the U.S.—has consequences. It affects the way land is used, the care it is given, and even extends into the quality of community of life. Rural sociologists report that communities with high rates of farm tenancy have weaker social institutions than communities characterized by farm ownership.*

Financial returns for the investor in farmland can come from two main sources, rental or share-lease income from a farmer, and/or the appreciation of the real estate itself. There are several models or options for partnering with investors in farmland that might be appropriate for the community supported farm. In order to craft arrangements that reduce the risk of compromising community values, neglecting land stewardship and setting false expectations, both farmers and investors will benefit most by having clear, informed communication which includes open sharing of goals and vision during the initial stages of pursuing an agreement—*before any formal commitment is made from either party.*

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24 Recently TIAA-CREF, one of the largest pension funds and money managers in the world, took a controlling interest in Westchester Group Inc., controlling $1 billion worth of agricultural assets and 320,000 acres of farmland as investments. TIAA-CREF also recently met with several other large international investment firms to adopt the “The Principles for Responsible Investing in Farmland: 1. Promoting environmental sustainability, 2. Respecting labor and human rights, 3. Respecting existing land and resource rights, 4. Upholding high business and ethical standards, and 5. Reporting on activities and progress towards implementing the Principles and promoting the Principles.” http://www.tiaa-cref.org/public/about/press/about_us/releases/pressrelease1096.html. Accessed online 2/14/2012.

25 Various reasons for rental rate and farm revenue predictability include government commodity program payments and the economies of scale of large-scale cropping systems.

Five early-stage talking points with considerations are detailed below. They are:

1. What is the investor’s motivation for purchasing the farmland and seeking partnership with the farmer?
2. What is the farmer’s motivation for seeking partnership with the farmland investor?
3. What kind of management rights and responsibilities will result from the farmer-investor partnership?
4. Who else can assist in developing the arrangement?
5. What type of agreement will be used?

**TALKING POINT #1: What is the investor’s motivation for purchasing the farmland and seeking partnership with the farmer?**

In the traditional model, the investor purchases the land and pays all associated ownership costs. The farmer leases the land and pays cash rent to the landowner. There are many variations of this model, depending on the motivation of the investor. It is useful to uncover and articulate motivations in order to clarify expectations. Clarifying expectations saves time and energy from avoiding unproductive relationships and arrangements, and/or enables agreement terms to be set to preempt situations from unexpectedly turning sour in the future.

Three types of farmland investors are described below. Keep in mind, a person will likely have multiple motivations, and span across each of these three descriptions:

A) An investor motivated by the prospect of short to medium term financial gain will focus on the cash rent (dollars per acre per year) in terms of how it factors into the “capitalization rate”27 or percentage of the original purchase price the landowner will get as a financial return. A really serious investor might compare this capitalization rate to other investments. If a farmer hopes to partner with this type of investor, it is important to be up front about the cash rent that can be paid per acre per year, or what portion of the landowners ownership costs can be covered by the farmer. The farmer should be realistic about what the farm business can handle, and anticipate the landowner to be particularly interested in talking through the numbers.

Some investors recognize that investments can have social or environmental impact and these investments can generate superior financial returns. This is exemplified by the trend in investing in organic farmland. Investment partnerships have been launched recently that specialize in the purchase of land, converting it to certified organic land, and leasing it to organic farmers.28

B) Another type of investor is motivated by the prospect of long-term capital appreciation from reselling the land in the distant future. Year-to-year potential returns from cash rent from a farmer are secondary concern. This investor will usually take the most hands-off approach to any other described here. The motivation is often to purchase land as a long-term investment for the kids or family. Having a farmer on the land is desirable, and in many states will enable the landowner to benefit from a significant reduction in property taxes; but the desire to host a farm business is secondary to finding the right piece of land to purchase and hold onto. There is usually little prospect of the farmer gaining a chance to acquire these types of farms via a later purchase or lease-to-own scenario.

C) Finally, there is the investor who is motivated, at least in part, by the desire to have a beneficial impact on local agricultural development. This type of investor might not consider themselves to be an “investor” in the traditional sense. Among primary purposes for seeking farmers are to provide opportunities for land access or local agricultural economic development, and to enjoy having a farm on or near their property. This type of investor has good intentions, but can frequently be the most “hands-on” of the three types described here. Farmers might underestimate the amount of time spent familiarizing the investor with plans for farming and with how farms operate in general. The advantage is that there can be opportunities to partner with this type of investor beyond strictly renting the land. The investor can provide capital through flexible and patient mechanisms outlined in this guide. The arrangement might enable the farmer to significantly

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27 Capitalization rate, or cap rate is defined by investopedia.com as “A rate of return on a real estate investment property based on the expected income that the property will generate. Capitalization rate is used to estimate the investor’s potential return on his or her investment. This is done by dividing the income the property will generate (after fixed costs and variable costs) by the total value of the property.” http://www.investopedia.com. Accessed online 12/2/2011.

For more information about capitalization rates: http://www.investopedia.com/terms/c/capitalizationrate.asp#ixzz1PjsixW.

28 Farmland LP, based in California, is one such investor partnership. From their website, http://www.farmlandlp.com (accessed online 1/13/12): “Farmland LP acquires conventional farmland and converts it into certified organic, sustainable farmland. Our investors benefit from the security of owning farmland while participating in the growth and profitability of the organic market.”
build a base of equity and capital that stays with the farmer wherever he/she ends up down the road. The investor can be a welcome presence at or around the farm. Depending on personalities or characters, these arrangements can be assets or obstacles in the eyes of a farmer.

The most common way these types of relationships fail is when the farmer and non-farming partner find themselves years into the arrangement and have a fallout about an “improvement” or alteration to the land. It is especially important to have mutually understood boundaries and clearly communicated expectations for what all parties plan or want to see happen on the land. (See Farm Case Study, Bloomfield Farm, for lessons learned in communication). Keep in mind that the non-farming investor/landowner will likely be in the process of increasing their understanding of how agricultural systems and economies work. They will be looking to the farmer as a patient teacher. What might be common knowledge to the farmer might be foreign to the farmland investor (and visa versa).

**TALKING POINT #2: What is the farmer’s motivation for seeking some form of partnership with the farmland investor?**

Farmers should be clear on what their goals are, both short- and long-term. They should articulate these goals in conversations with potential capital partners. Is a goal to access land for the long haul? Is it to provide an area for short-term expansion and enterprise growth? Is the goal to provide somewhere to reside and settle down for an extended period? In many cases, owning a farm or tract of land via partnerships with farmland investors is not an option. It is more typical for arrangements to be crafted with farmland investors to allow the farmer to lease the land on a short term basis, i.e., one to five years. This might be perfectly acceptable, especially in cases where the farm’s “home base” of operations is already established and the farm is looking to expand onto more land for production. Either way, partnering with an investor can provide opportunities for avoiding or sharing the high up-front costs of land ownership, enabling farmers to build equity in other business assets.

Farmers can communicate openly and clearly about their motivations. After talking with the investor, the farmer should be able to determine whether ownership of land or operating with the security of a long-term tenure arrangement is an option. If it is not, the farmer who is motivated by the prospect of long term secure tenure acquisition, either through purchase or long-term lease, might want to explore other land access options.29

In cases where acquisition will take place by the farmer by purchasing back real estate from the investor, for example in a “lease-to-own” arrangement, clear terms need to be set on how to determine when and in what manner the purchase will be “triggered.” These types of arrangements tend to fail when, although there is a mutual understanding that the farmer will work towards acquisition and build equity during the lease process, there is no specified manner at the outset of the arrangement in which transfer of ownership will start to take place. On the other hand, there can be a real potential for success when both parties work together to iron out a timeline for the farmer to acquire ownership of assets, and detail the process by which transfer of ownership will take place.

Both farmers and the investor (in this sense, a “land holder”) should be realistic about the time horizon in which the farmer can buy back land from the investor. Both family needs and realistic projections for the business need to be taken into account. In general, it is advisable, if not necessary, to consult with tax accountants and attorneys when developing any type of “lease-to-own” arrangement. For more information on mechanisms for farm transfer and transitions, such as a Lease-

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29 Many non-profit government and other organizations throughout the Northeast offer consulting and assistance to farmers in comparing the pros and cons of various farm access options. Contact your local Cooperative Extension office, state Department of Agriculture, or other non-profit agency, such as Land for Good (http://www.landforgood.org) for more information on who can meet with you or services available to assist you navigate through farm tenure and business partnership options.
option agreement, or any other variation of a “lease-to-own” agreement, contact Cooperative Extension, local agricultural non-profit service providers, or attorneys and tax accountants with familiarity with real estate and tax law. One particular model, the “Land Buyback Model” is described in greater detail the sidebar above.

**TALKING POINT #3: What kind of management rights and responsibilities will result from the farmer-investor partnership?**

There can be a very clear distinction, legally speaking, between owning an asset and managing it. In farm partnerships it is common for one party to own an asset, such as land, but not have the right or responsibility to manage it. This is commonly known as a limited partnership. For example, one partner’s rights might be “limited” to owning land but not having the authority to engage in business transactions or decide how the land is used for production. In order to hold up in court, the limited authority must be documented in the original partnership agreement in the “statement of partnership authority,” which is filed at the Secretary of State’s office.

Lease agreements also have provisions that specify permitted and prohibited uses of the land. This can serve a similar purpose as a “statement of partnership authority” to clarify and place on record what the landowner and farmer-tenant have agreed to be reasonable practices that the farmer can implement without the ongoing consent of the landowner. Often the lease contains additional provisions that detail a process in which the tenant can obtain written permission from the landowner to implement a practice that was unforeseen or originally questionable at the time of crafting the original agreement.

It is safe to expect at the outset of any type of partnership (legal or informal) that parties will encounter differences in opinion down the road. “Farmscapes” can change significantly over time as buildings and infrastructure are put in place to accommodate growth in the operation. Even the most well-intentioned partnership can encounter rough spots when parties disagree on the degree and manner in which changes are implemented. It is therefore critical in early stages of developing arrangements to converse as openly, transparently and specifically as possible about the short-, medium- and long-term visions of all parties involved, regardless of their legal status. Documentation of the nature of management rights and responsibilities is highly recommended, but the success of the arrangement ultimately hinges upon open communication between parties that develops trust and confidence that intentions are clear, and when issues arise they can be resolved diplomatically.

**TALKING POINT #4: Who else can assist in developing the arrangement?**

1. State Cooperative Extension agencies have farm business management specialists on staff who are experienced in explaining the nuts and bolts of different types of partnership or lease arrangements. Extension educators’ role is to serve communities by being non-biased, and by providing relevant research-based information. Extension staff are often trained facilitators. They will sometimes have the capacity to travel to the farm to assist in meetings. Otherwise, Extension can provide you with free educational materials or point you to other resources that might meet your needs.

2. Other non-profits, such as land trusts, exist with the missions of preserving states’ rural heritage, keeping farm landscapes open and productive, and assisting new or relocating farmers’ with land access or farm tenure arrangements. These organizations offer a “cafeteria” menu of support services. While dealing with farm investors is a relatively new program area, these non-profits might have educational resources on the topic of partnering with investors. They might be in touch with investors who share their missions, and might be able to connect farmers directly with these investors when appropriate. Some non-profits in the midwest have this explicit purpose, to serve as the facilitator of farmer-investor relations.

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30 Id.


32 An example of an Extension publication routinely used in early negotiating stages to develop partnership agreements is the General Partnership for Agricultural Producers Agreement Worksheet. The PDF is a seven-page publication from Michigan State University Extension. It includes questions and blank lines for farmers to use before going to a lawyer when considering a business arrangement. Questions include: Contributions of each partner; distribution of salary and profits; management and dissolution, the exit strategy. Accessed online on 1/6/12 at http://web2.msue.msu.edu/bulletins/Bulletin/PDF/E2119A.pdf.
3. Investment firms or private money managers will be interested to talk with farmers who are actively seeking investment. Some of these firms' investor clients might desire to diversify their portfolios and support local food systems, or might be open to the idea of investing in farmland for the prospects of financial gain alone. Either way, farmers should recognize this is a new sector or topic area, and investment managers might not look favorably on the amount of risk involved. On the other hand, if the farmer is prepared to present a convincing business plan or idea, and has a thoroughly-researched strategy for expanding into markets with high-demand, the broker or financial adviser might be intrigued.

4. Accountants and attorneys should be consulted to discuss tax and legal implications of any agreement, at the very least towards the later stages of developing an agreement. Some accountants and attorneys might offer free consultations or services on a sliding payment scale to help farmers determine where the biggest areas of risk are or how they might assist as the arrangement is developed. The farmer and investor can do as much homework as possible before paying accounting or legal fees by accessing educational resources of Cooperative Extension or other organizations. Accountants and attorneys will appreciate this, as it might make their work more efficient (thereby lessening their time involved and the total cost of services).

TALKING POINT #5: What type of agreement will be used?

A written agreement serves many purposes. The professionals mentioned above (in talking point #4) can assist farmers and investors choose the most appropriate one. All types of agreements should have the basic elements of a contract. It is important for both the farmer and investor to understand the value of a contract. A thorough contract can help avoid any potential problems, and can offer solutions if problems do arise. Crafting an effective contract can involve a significant amount of time and relatively high upfront costs, but having a written agreement in place can avoid many potentially time-consuming and costly legal problems in the future.

The following types of agreements might be applicable for farmers and farmland investors:
- Purchase and Sales Agreement
- Lease-Option Agreement
- Land Contract (See Chapter 3: Owner-Financed Sales and Land Contracts)
- Owner-financed Sale Agreement (See Chapter 3: Owner-Financed Sales and Land Contracts)
- Share Lease
- Farmland Lease Agreement
- Partnership Agreement (There are many different types, including General and Limited Partnerships.)
- Ground Lease (This is an arrangement where the tenant owns and can resell buildings but does not own the land.)

Templates and samples can be found online all over the Internet, but the reader is cautioned that these samples might not factor in all considerations applicable to specific circumstances. A separate qualified attorney should represent each party to any legal agreement, and review the agreement before it is finalized. Parties should also consult with a tax accountant before the agreement is finalized to fully understand tax implications.