

THE NEW YORK FAMILY OFFICE

Your Contact in the U.S.

Newsletter: 4th Quarter 2013

Economic Outlook

Despite Some Speed Bumps Ahead, the Road Is Expected to be Smoother in 2014 (Page 2)

Farmland

Increased Interest in U.S. Farmland (Page 2)

Economic Factors behind Farmland Values (Page 2)

Parcel-Specific Factors behind Farmland Values (Page 5)

Market & Financial Data

Economic Indicators & U.S. Dollar Foreign-Exchange Rates (Page 7)

Interest Rates, Real Estate & Taxes (Page 8)





Despite Some Speed Bumps Ahead, the Road Is Expected to be Smoother in 2014

From the first quarter 2009 through September 2013, the U.S. economy grew at an annual growth rate of 2.1% (adjusted for inflation). The Great Recession of 2008-2009 was the steepest since the Great Depression of the 1930s and the U.S. economy experienced the slowest expansion after any recession since the Second World War. As a result, the current capacity utilization rate of 78% is still below the average of 82% and unemployment at 7.3% is still higher than normal after four-and-a-half years of expansion.

That said job growth remains solid with gains of 203,000 jobs in November 2013 despite slowing economic growth in the last quarter. The decreasing trend in the unemployment rate is an encouraging indicator for growth. Decreased unemployment encouraged the Federal Reserve to start tapering its quantitative easing in December. It is expected that Janet Yellen, the new Federal Reserve Chairman, will continue to slow the bond buying initiative depending on where inflation is headed.

The increase in yield on mortgages slowed housing activity in the last quarter of 2013, but the optimistic assumption is that more jobs and increased household income will not only bolster consumption but also support continued recovery in the housing market. American consumers are winding down deleveraging (paying off old debt) but still remain reluctant to spend on other than necessity-driven vehicle replacements and aggressively discounted retail items. Economists expect that during the Holidays consumers were hunting for bargains and spending based on need. However, they predict better times for 2014 as the housing recovery continues and the fiscal drag lessens. Overall, economic growth is expected to accelerate to about

2.5% in 2014.

Increased Interest in U.S. Farmland

In Europe, the financial crisis caused many families and family offices from Germany, Switzerland, and Austria (GSA) to reconsider their investment and asset allocation strategies. They are increasingly turning to investments that are easy to understand and re-discovering traditional investments in real assets including timberland and farmland. Given the scarce product and rising prices in GSA, more and more investors are considering to buy in the much larger U.S. market. An article about timberland investments was written in our 3rd quarter 2013 newsletter. Please find in this edition information about investments in U.S. farmland.

In general, interest in U.S. farmland has grown in recent years due to strong increases in values, which have been more than 10% in 2005 and 2006. A study published in February 2012 by the United States Department of Agriculture (USDA) examined what affects farmland values and identified two main drivers: Economic and parcel-specific factors.

Economic Factors behind Farmland Values

Economic factors behind farmland values – such as expected returns from agricultural uses, alternative investment opportunities, interest rates, and use of debt financing – and other sector-level factors help inform whether farmland continues to be attractive as an investment and whether farmland values appear to be supported by fundamental farm factors.



1) Rent-to-Value Ratios Declined over the Last 50 Years

The farmland rent-to-value (RTV) ratio, calculated as the cash rent per acre divided by the land value per acre, is a proxy for how quickly an asset will pay for itself. A roughly 45-year trend reveals a decreasing RTV ratio. If agricultural rents were the sole source of returns from farmland, the farmland would have paid for itself in about 14 years in 1951, but would take more than 33 years in 2007.

However, in many places, non-agricultural returns can be earned from the land, such as returns from developing the land. Decreasing RTV ratios are consistent with the growing importance of non-agricultural factors in determining land values. Actually, in Georgia, non-agricultural factors have a stronger influence on land values than cash rents.

2) Affordability of Farm Real Estate Has Varied over Time

As farmland values surge and rent-to-value ratios decline, questions arise about the affordability of farmland, the maximum farm real estate value for which current farming income can service debt each year.

Although affordability will fluctuate above and below real estate values due to price and yield variation, the study found that during two periods in particular – 1978-1985 and 2005-2008 – income from farming alone was insufficient to service the debt on farm real estate purchases. The low levels of affordability indicate that nonfarm factors likely had a large role in determining farmland values during these periods. In other periods, such as before 1974 and between 1986 and 2004, farming incomes were more aligned with the value of land.

3) Narrow Market

When farmland values are high and affordability is low, some farmers might sell land to capture the capital gain benefits arising from appreciated land values. Yet, other farmland owners will not necessarily react by immediately selling their land. Farmland markets have historically been very thin, with some estimates indicating about 0.5% of U.S. farmland is sold annually.

Farmland owners may hold onto land if the family has held it for a long time or because they derive other non-financial (lifestyle) benefits from owning the land. Indeed, studies of farmland market activity reveal that sales of farmland are often forced due to death or retirement rather than a result of affordability levels.

4) Farmland Values Were Supported by Farm Earnings in 2009 and 2010

From an investment perspective, capitalized values are used to quantify impacts of both cash rent and interest rate changes on land values. A capitalized value represents the estimated discounted value of all future cash flows to farmland. The capitalized value is calculated by dividing cash rent (a measure of cash flow generated from agricultural production) by a discount factor, typically an appropriate interest rate. When farm real estate values divided by the capitalized value (price-to-value ratio) exceed 1, farmland values are not supported by the stream of cash flows the farmland could earn.

During 2004-2008, farmland values were not justified based on farm earnings alone. Subsequently, market signals indicate that farmland was somewhat undervalued at current interest rates, so it is not surprising that farmland values increased in 2009-2010. Since 2009, though farmland values have been high, the discounted returns from renting farmland have been high.





her. Also average income from farming has been more than sufficient to service the debt on farm real estate purchases at current mortgage rates.

Significant volatility in urban real estate markets over the last decade has raised questions about the extent to which competing land markets are affecting farmland values. In addition to its value in a farming use, farmland near urban areas derives value from its potential to be developed for residential housing and other nonfarm purposes. A comparison of rural housing and farmland values during the 2001-2004 “boom” years of the housing market reveals that farmland values grew faster than rural housing values in many states. During the housing market downturn (2007-2009) that affected all but the Plains and Delta regions, farmland values generally declined more moderately than rural housing values. In 19 states (notably California, Oregon, Washington, and Nevada) farmland values continued to increase even though rural housing values declined. Strong farm earnings appear to have helped farmland markets withstand the significant downturn in the residential housing market in recent years, though some (urban) regions may have experienced modest impacts.

5) Low Interest Rates

Historically low interest rates are likely a significant contributor to farming’s current ability to support higher land values. Increases in interest rates would likely put downward pressure on farmland values.

The current environment of low interest rates has three positive effects on agricultural real estate values. First, for those who have to purchase land with debt capital, it lowers the total cost of purchasing land. In 2009, over half of farm real estate transactions involved debt financing for 75% or more of the purchase price. Second, interest rates represent returns on

competing fixed investments, and when they are low, farmland looks more attractive as an investment alternative. Coupled with increases in crop prices and improved agricultural credit conditions, some regions experienced double-digit increases in farmland values in 2010. Third, low interest rates also aid those who are buying farmland for other uses of the land.

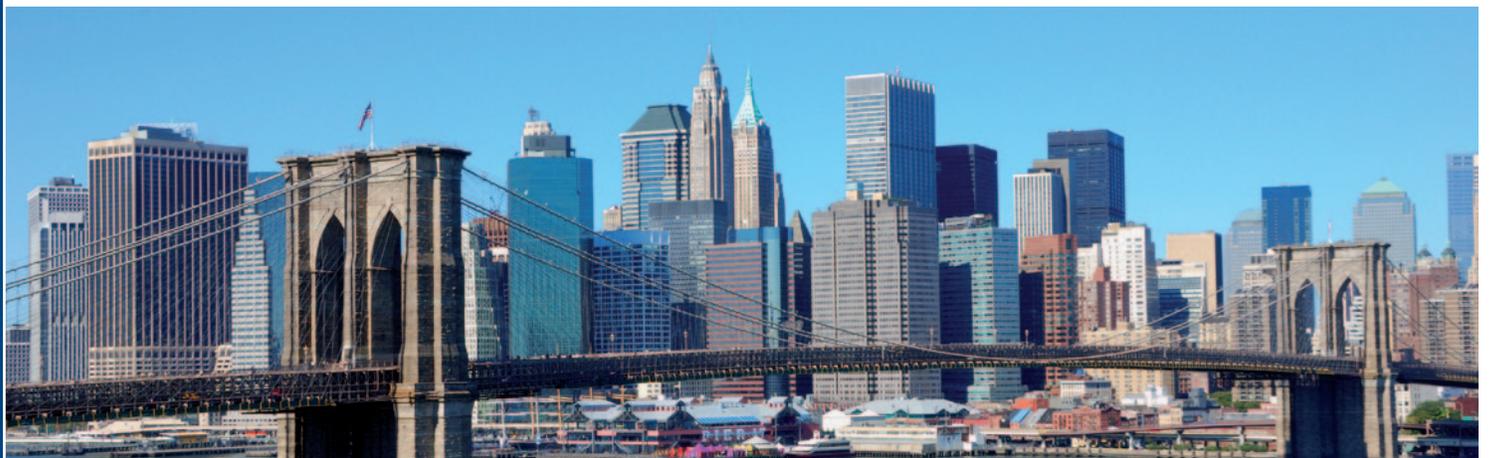
6) Attractiveness of Farmland Compared to Other Investments

Since the farm crisis of the mid-1980s, farm real estate values (including land and buildings) have been rising in both nominal and real (inflation adjusted) terms. Between 1994 and 2004, real values increased between 2% and 4% annually. In 2005 and 2006, values jumped 16% and 11%, before slowing to 6-7% in 2007 and 2008.

Farmland has historically been a stable investment and has become more attractive relative to other investments in recent years, as reflected in surveys that indicate active investor interest in farmland, at least in some regions: nearly a quarter of farmland purchases in Iowa were made by investors in 2009. However, uncertainty about the renewal of major farm commodity programs and future interest rates could reduce the attractiveness of farmland as an investment relative to other alternatives.

7) Relatively Little U.S. Farmland Is Foreign Owned

High levels of foreign demand for farmland could put upward pressure on farmland prices. Despite recent increases in foreign ownership of forest land, annual data compiled by USDA’s Farm Service Agency reveals that, as of February 2009, only 1.7% of privately owned land in farms or forest, or 22.8 million acres (9.2 million hectares), was owned by foreigners. Please note that laws in some states limit farmland ownership by foreign owners.





The majority of foreign-owned land is owned by people or firms from two countries: Canada (34%) and the Netherlands (17%). Most foreign ownership is concentrated in Maine: 15.7% of Maine's privately owned farm and forest land, or 2.82 million acres (1.14 million hectares), is foreign owned. Of this amount, 2.77 million acres (1.12 million hectares) are forest land. Other states with relatively high levels of foreign ownership of farm and forest land include Hawaii (8.8%), Washington (7.6%), Nevada (5.2%), and Alabama (5.1%). Foreign interests own 2.57 million acres (1.04 million hectares) in Texas.

Parcel-Specific Factors behind Farmland Values

A micro-level perspective reveals how farmland values vary spatially due to variation in parcel-level characteristics like soil productivity, the land's proximity to markets, eligibility for farm program payments, and opportunities for nonfarm income.

1) Farm-Related Factors Affecting Farmland Values

a) More Productive Soils Are Correlated with Higher Cropland Values

Farmland with better soil quality can improve yields and reduce production inputs and management time, which can enhance farming returns and thus farmland values. However, the contribution of better quality soils to farmland values can vary depending on the proximity of the land to urban areas.

In the most rural areas where urban pressures are largely nonexistent, cropland with better soils is correlated with higher land values. However, a positive correlation between soils and land values is difficult to detect near urban areas because so much of the land's

value derives from potential development uses and not farm factors.

Historical relationships between cropland and pastureland values have changed in some regions. Cropland values have typically exceeded pasture values and have been at least twice as large as pasture values in the Midwest and West in the last decade. But the premium has shrunk recently, and in two regions – the Southeast and Delta – average cropland values have remained below average pasture values since 2004-2005. Studies suggest that nonfarm factors could be contributing to the relative changes in crop and pasture values. Pastureland can provide a stream of recreational income from hunting leases, and in the Southeast, pastureland tends to be closer to urban areas and development demand.

b) Land Value Effects of Proximity to Transportation Infrastructure and Market Channels

Because transportation costs increase with distance, the proximity of land to important points of delivery for crops can affect net returns and land values. Cropland values generally increase with proximity to points of delivery (grain elevators, highways, ethanol plants, urban centers) in rural areas.

2) Nonfarm-Related Factors Affecting Farmland Values

a) Farm Real Estate Values Are Positively Correlated with Proximity to Urban Areas

The demand for land that can be developed for urban use is the most significant nonfarm factor affecting farmland values in areas that are more urbanized or experiencing fast population growth.

While proximity to population centers and increa-





sed access to markets and customers could influence farmland values by increasing expected agricultural returns, development demand for residential, commercial, and industrial uses tends to increase farmland values even more. The U.S. population continues to grow and disperse, and all states are experiencing urban-related influences on farmland values to some degree. To acquire land for nonagricultural purposes, developers typically must bid higher than the agricultural production value of the land. As a result, even a limited number of conversions of farmland to urban uses can lead to generally higher farmland values in areas influenced by urban demand for land.

b) Link of Farmland Values to Rural Housing Markets

Significant volatility in residential real estate markets over the last decade has raised questions about the extent to which demand for development land affects farmland values.

A comparison of rural housing and farmland value trends in different states – that are distinct in terms of location, agricultural production and residential housing – reveals that the boom-and-bust cycle in the housing market in the last decade had no, or relatively modest, negative impacts on farmland markets.

c) Natural Amenities Are Positively Related to Farm Real Estate Values

A number of studies suggest that like other land values, farmland values are influenced by the amount and nature of natural amenities, such as scenic views and varied terrain that attract people to an area.

An analysis of population changes suggests that high-amenity counties next to metropolitan areas are the most desirable places to live, so high-amenity areas could increase the development value of the land.

d) Correlation between Government Payments and Cropland Values

The correlation between government payments and cropland values varies regionally and by payment type. Government agricultural program payments increase income from agricultural production, and when they do so in a consistent way, the expectation of future payments may be capitalized into the value of farmland.

The ratio of direct and countercyclical program (DCP) payments and insurance premium payments to land values varies regionally, a consequence of what crops are – and have historically been – grown and whether they are eligible for program payments.

Farm program payments are under increased scrutiny amid a historic debate over the size of the federal deficit. Changes to some of the largest farm programs would likely have impacts that vary across regions.

Conclusion

Given the declining areas of farmland in comparison to a steadily growing world population, some prudent investors with long-term time horizons consider ownership of farmland as an interesting investment strategy. However, for U.S. direct investments in farmland it is critical to understand local aspects from an economic and tax perspective and receive qualified information. As your contact in the U.S., The New York Family Office is happy to assist as your independent advisor at site and upon request provide access to co-investment opportunities with U.S. families and family offices.



Economic Indicators & U.S. Dollar Foreign-Exchange Rates

Economic Indicators	November 2013	September 2013	November 2012	November 2010	November 2008
Employment	203,000	148,000	146,000	39,000	(533,000)
Unemployment Rate	7.0%	7.2%	7.7%	9.8%	6.7%
Avg. Weekly Hours (Manuf.)	41.0	40.8	40.6	40.3	40.3
Avg. Overtime Hours (Manuf.)	3.5	3.4	3.2	3.1	3.3
Building Permits	1,007,000	974,000	899,000	530,000	616,000
Housing Starts	1,091,000	873,000	861,000	555,000	625,000
Consumer Confidence Index	70.4	80.2	71.5	57.8	44.9
Purchasing Managers Index	57.3	56.2	49.9	58.2	36.5

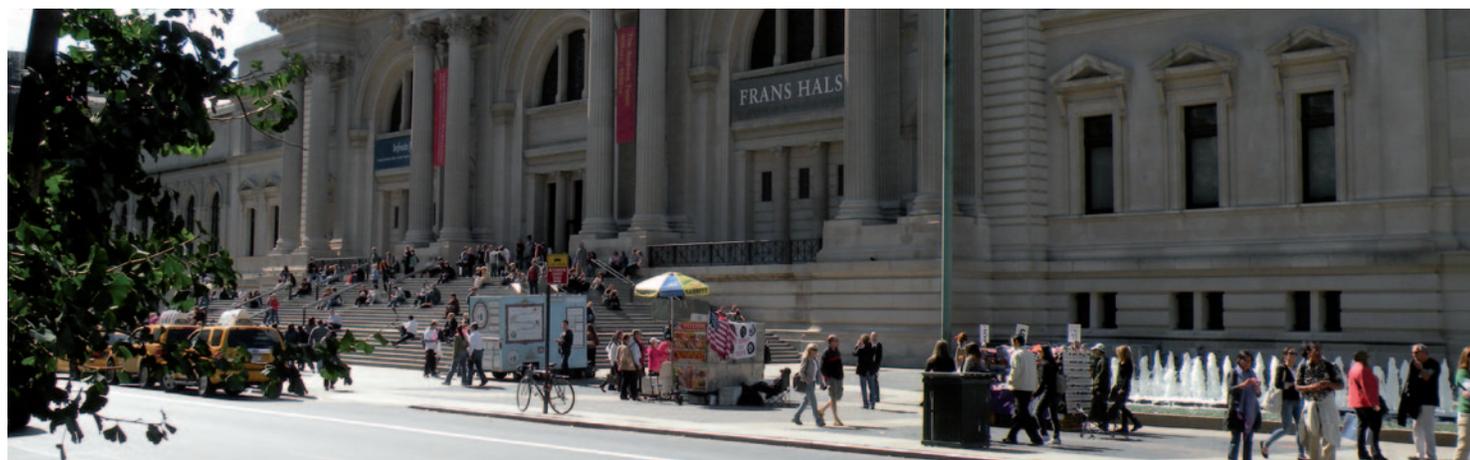
Other Indicators	Nov. 30, 2013	Sept. 30, 2013	Nov. 30, 2012	Nov. 30, 2010	Nov. 30, 2008
S&P 500 Index	1,805.81	1,681.55	1,416.18	1,180.55	896.24
S&P 500 - Trading Volume (in thousands)	1,598,300	3,308,630	3,966,000	4,284,700	2,740,860
VIX (Volatility Index)	13.70	16.60	15.87	23.54	55.28

Real GDP	2013 Q3	2013 Q2	2012	2010	2008
Real GDP	4.1%	2.5%	2.2%	3.0%	(0.3%)

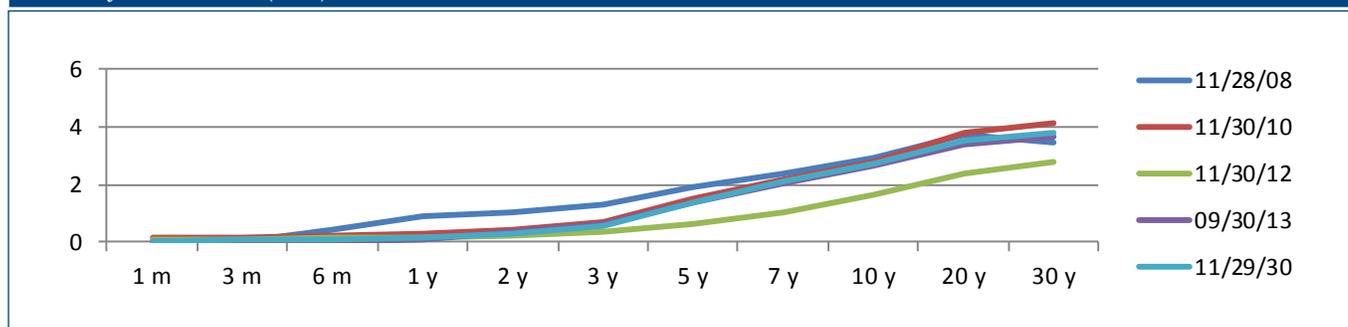
Inflation	November 2013	September 2013	2012	2010	2008
Inflation	1.2%	1.2%	2.1%	1.6%	3.8%

Currency Exchange Rates	Nov. 30, 2013	Sept. 30, 2013	Nov. 30, 2012	Nov. 30, 2010	Nov. 30, 2008
EUR / USD	1.3588	1.3520	1.2966	1.3192	1.2904
GBP / USD	1.6318	1.6136	1.6022	1.5584	1.5387
CHF / USD	1.1028	1.1031	1.0769	1.0243	0.8331
CAD / USD	0.9445	0.9698	1.0078	0.9800	0.8128
CNY / USD	0.1631	0.1626	0.1593	0.1499	0.1462
JPY / USD	0.0098	0.0102	0.0122	0.0119	0.0105

Note: Some Numbers May Be Updated Due to Revisions of Official Statistics.



Interest Rates, Real Estate & Taxes

Treasury Yield Curve (in %)


Base Rates	January 8, 2014	2 Weeks Ago	One Year Ago
30 Day LIBOR	0.16%	0.17%	0.21%
U.S. Treasury			
5 Year	1.72%	1.73%	0.80%
10 Year	2.98%	2.99%	1.91%

10-Year Fixed Rate Ranges by Asset Class	Max. LTV	Class A	Class B/C
Anchored Retail	70-75%	T + 205	T + 220
Strip Center	65-70%	T + 220	T + 235
Multi Family (Non-Agency)	70-75%	T + 195	T + 205
Multi Family (Agency)	75-80%	T + 195	T + 200
Distribution/Warehouse	65-70%	T + 195	T + 210
R&D/Flex/Industrial	65-70%	T + 210	T + 230
Office	65-75%	T + 195	T + 215
Full Service Hotel	55-65%	T + 255	T + 280

Note: T = Interest Rate for 10-Year U.S. Treasury (2.98%)

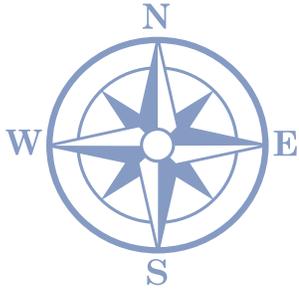
Source: Cushman & Wakefield (January 8, 2014)

Simplified Presentation of the Most Important U.S. Federal Tax Rates:

Income Tax	10-35% / 10-39.6%*
Long-Term Capital Gains (LTCG)	15% / 20%*
"Qualified" Dividends	15% / 20%*
Corporate Tax	15-35%
Gift and Estate Tax	18-35% / 18-40%*

Note: * = As of January 1, 2013 higher tax rates apply for individuals earning more than \$400,000 (and couples earning more than \$450,000).





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For questions or scheduling meetings, please contact us.
We are looking forward to hearing from you.

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