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A changing landscape

Tracking the dynamic agri investment market across the value chain

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Welcome

Dear reader,

Welcome to our special *Agri Investor* compendium.

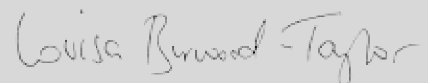
Regular visitors to our website will know we offer a unique daily mix of stories, often providing new details and key insights on market developments. We track the institutions, funds and transactions shaping the agri investment market.

We also showcase handselected, third-party commentary and research from industry thought leaders on a weekly basis.

This compendium collates some of the most interesting – and most popular – items we've published recently, giving you an informative snapshot of today's agri investment market.

We hope you enjoy the collection and encourage you to visit our website for more – www.agriinvestor.com.

Best wishes,



Louisa Burwood-Taylor
Editor – *Agri Investor*

China's agri sector ripe with opportunity, but risks inherent, says market

The time is right to be investing into China's agriculture industry, according to a private equity professional and an Asia-based placement agent.

Stuart Pang, managing partner at Pinetree Capital Partners, a private equity firm that is currently fundraising for Fund II, a fund that will invest part of its capital into agriculture alongside healthcare, services and consumer-related industries, believes that the Chinese government's approach to the agriculture sector is particularly appealing.

"If you invest in China you need to be able to read the winds of change in terms of regulatory changes. Chinese regulations change all the time and they can affect your interests as an investor," Pang tells *Agri Investor* "But it seems that it is very safe to invest in the agriculture sector because this sector is promoted by the government; it is encouraged and protected because China has attached a big priority to food security, safety and supply."

> "Chinese regulations change all the time and they can affect your interests as an investor."
> **Stuart Pang, managing partner at Pinetree Capital Partners**

"The government wants the agriculture sector to be more efficient and have always had the initiative to encourage its development," he adds.

Areas such as soil fertility improvement provide particular opportunity for investment, according to Pang, because "run-off is a particular concern in China".

"The condition of agriculture and soil in China is a big opportunity for investment as firms work with universities in various provinces to study the soil and companies are looking at way to improve marginal/desert land for crop growth," says Pang.

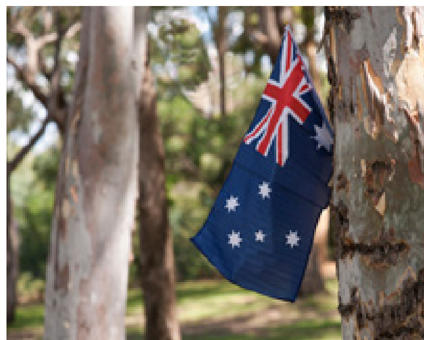
Vincent Ng, partner at Atlantic-Pacific Capital agrees that the regulatory environment is suitable and the opportunities for improvements are attractive. But he expresses some concerns about the risks involved.

"On a regulatory basis the government is pushing better food quality and higher yielding food production out of China and considering the low technology base from which its farmers are coming, there is a lot of opportunity for improvements, and therefore investment return," says Ng. "But there are two sides the coin. This low technology base, and low efficiency in China's agriculture market also means there are greater risks. How can you complement new technology into existing operations, for example?"

Buying opportunities abound in Australian forestry

Buying opportunities in the Australian forestry market have increased as the life cycle of trees purchased after the collapse of several investment schemes in the mid-2000s comes to an end, according to Tim Altschwager, director of rural and agribusiness at Colliers International, the global commercial real estate company.

Forestry land prices were pushed up artificially high in the late 1990s and early 2000s when management investment schemes were first established due to the extra demand, but also because many of the schemes bought land that was not worth the price they paid, according to Altschwager.



"Some even bought land that was not suitable for forestry but converted it," he told *Agri Investor*.

Several managed investment schemes collapsed a few years later when timber and wood chip markets fell and their assets were bought up by several investors. This included Future Fund, Australia's sovereign wealth fund; AustralianSuper, the superannuation fund; and the Australian Sustainable Forestry Investors Fund (ASFI).

Now that the typical 10-year life cycle of trees has come to an end, there are several Australian forestry assets on the market that are priced at around 50 percent lower than they were in the early 2000s, according to Altschwager.

"There are a lot of assets coming up on the market at the moment," he said. "They changed hands when the managed investment schemes went under and now we are in the second cycle with forestry companies as well as investment firms buying them."

The global financial crisis also wreaked havoc with the managed investment trusts placing more forestry assets on the market a few years later, according to David Brand, founder and chief executive of New Forests.

"It has taken a few years to work through the system and once that is done, that will be the end of it, but for now it is still very much a buyers' market," he said. "That will probably shift in over the next few years."

Colliers International recently managed the sale of nearly 21,000 hectares of forest-

> "There are a lot of assets coming up on the market at the moment."
> " Tim Altschwager, director of rural and agribusiness at Colliers International

ry land by ASFI to New Forests, a global sustainable timberland asset management firm based in Australia. This was the first acquisition for the New Forests Australia New Zealand Forest Fund 2, a 10-year stapled unit trust that closed on A$707 million ($662 million; €484 million) in March. ASFI acquired the assets from Timbercorp, one of the managed investment scheme managers that sold its assets in 2004.

New Forests Fund 2 is also buying 175,000 hectares of north-western Tasmanian land and forestry assets from Gunns Limited, the managed investment scheme management firm that went into liquidation in September 2012, according to the Gunns website. The deal should complete at the end of June, according to New Forests. Fund 2 has a three year investment period.

The ASFI sale was competitively bid by individual investors, land owners, neighbours and investment firms, some of which bid for parts of the portfolio, which comprises 68 properties across South Australia, Victoria and Western Australia. But selling the portfolio in one deal was a "far superior option", said Altschwager.

New Forests is likely to convert some of the land from forestry back to grazing and cropping land, as it was originally used. "This will happen where forestry is not the highest and best use, which depends on a number of site-specific, regional, and market factors," said a spokesperson at New Forests. "Our goal is to maintain a high-quality, long-term forestry estate."

Altschwager added: "New Forests are getting back to a sustainable model that works. When they cut down the trees they will determine whether the land is suited for forestry or for conversion."

SLM Partners negotiates hybrid investment

SLM Partners, the agriculture investment management firm, is negotiating an A$20 million – A$30 million investment with an undisclosed institutional investor that is likely to be a combined debt and equity package, according to Paul McMahon, managing partner at the firm.

The SLM Australia Livestock Fund, a 10-year own-and-operate private equity fund, held its first close in 2012 on A$75 million after Danish pension fund PKA came in as a sponsor investor. Now SLM is structuring a hybrid deal of both straight equity and convertible debt to suit what will be a first-time agriculture investor.

"A typical issue for first-time investors is where to fit an asset in their portfolio — it does not fit into traditional asset buckets — but with this hybrid they can dip their toe in the water to get some agri exposure but without going fully into equity," McMahon told *Agri Investor*. "The debt component makes it more familiar to them."

The investor is still a few weeks from confirming its participation in the fund. SLM is targeting A$150 million and is aiming for a final close at the end of the summer.

Since first close the fund has deployed nearly the full A$75 million. This has involved acquiring 480,000 hectares of land in 15 different properties across southern Queensland and northern New South Wales and transforming the land to suit the firm's farming technique known as holistic planned grazing. The fund's placement agent Bernd Meissner at Kronstein Alternative Investment Advisors calls it "Serengeti farming".

This method involves moving cattle from one paddock to another every few days in an effort to replicate how herds migrate in the wild and produce a sustainable ecosystem.

"If you look at herds grazing in the wild you will notice there are huge numbers in a herd and they stay closely bunched up to protect themselves from predators. They are always on the move in the search for fresh pastures," said McMahon. "The herd will come into an area and have a huge impact by non-selectively grazing and trampling. They may then not come back for many months, giving the land time to recover."

There is no set formula for how often the herd will be moved on each farm as that will depend on the weather and the operator's objectives. "If it rains and there is a lot of new grass growth we can move the cows quickly through the paddocks. When cows are calving we can slow down the moves so they don't lose each other," said McMahon.

Altering the land to suit this method involved creating several plots of land — one farm went from 20 to 200 paddocks after 600km of new single-wire electric fencing was installed. It also required investing in

> "A typical issue for first-time investors is where to fit an asset in their portfolio but with this hybrid they can dip their toe in the water to get some agri exposure but without going fully into equity."
> Paul McMahon, managing Partner at SML Partners

water infrastructure to ensure each paddock has enough drinking water for the cattle. The fund is using capital to acquire large numbers of cows as the goal is to double the stocking rate compared to conventional management.

Conventional farms will typically have a small number of cattle in each paddock that rarely move. SLM's farms will have large numbers of cattle in a single herd, constantly moving. On one of the properties it has fully developed, the fund was able to carry 50 percent more cattle than the historical stocking rate during 2013 - one of the driest and hottest years on record - "just by getting the grazing and water infrastructure right", said McMahon.

And 3,500 cattle are being moved as a single mob on one of the SLM farms already.

This model of beef production is also low cost, according to McMahon.

"There is no need for fertilisers or seeding, as the cows produce their own manure and the movement of the herd allows the native pasture to flourish," said McMahon. "The goal is for the animals to get all their nutrition from pasture, rather than purchased feed. The cost of labour is low, as once the infrastructure is in place, one or two people can manage a herd of a few thousands animals."

SLM considered other parts of the world including South America and the US but settled on Australia for its first project. It is likely to establish operations in other parts of the world at a later date.

"Australia is the best place to do this type of cattle farming because there are large amounts of land with year-round grazing and no harsh winters," said McMahon. "And the country's two main problems — natural grassland degradation and climate volatility — can be addressed through our method."

"The land degradation is in large part down to the inappropriate management of livestock. Under our system, the herds are moved across the land leaving areas to recover and regenerate for months at a time. This can also help to mitigate the impact of climate change and in particular climate volatility. Land that has less bare soil, more soil organic matter and healthier plants will be more resilient to both droughts and floods."

Equity investors in the fund buy stapled securities that give them a share in the company that operates the land and owns the cattle, and a unit in the trust that owns the land.

SLM Partners charges the typical 2 percent management fee and 20 percent carry. Its GP commitment was 1 percent of the fund's total.

Denmark launches public-private African agri fund

The Danish government is establishing an agriculture private equity fund to invest alongside local pension funds and private companies into the agriculture and food sectors of Africa, according to Niels Egerup, chief adviser in the government's Office for Green Growth.

The fund will be managed by the Investment Fund of Developing Countries (IFU), a government-owned fund tasked with investing into developing countries alongside institutions for commercial returns.

The fund's targeted investment return will be announced later.

The government will invest Kr40 million into the 10-year fund but hopes to attract a further Kr800 million ($146 million; €107 million) from local pension funds and other private investors. It will also mobilise capital from the private sector.

"We expect there to be great interest from Danish pension funds because some of them have already invested into agriculture," said Egerup. "Agriculture-related companies in Denmark are also likely to want to get involved either by co-investing alongside the fund and/or by supplying equipment and technology to the projects."

"In our experience we are able to mobilise six to eight times the amount of money of the fund," he added. "And this could also include co-investments from other development finance institutions and/or multilateral institutions."

During a speech announcing the fund's launch, Mogens Jensen, Denmark's trade and development minister, emphasised the need for Denmark's agriculture sector to use its expertise to help alleviate hunger problems in Africa.

THE GOVERNMENT WILL INVEST KR40 MILLION INTO THE 10-YEAR FUND BUT HOPES TO ATTRACT A FURTHER KR800 MILLION ($146 MILLION; €107 MILLION) FROM LOCAL PENSION FUNDS AND OTHER PRIVATE INVESTORS. .

"The investment could feed a lot of mouths and grow locally. Many African countries lack the harvesting machinery, processing plants to dry cereal and logistics to ensure that the food reaches the consumer in high quality. All that Danish companies can deliver," said Jensen at a food summit in Port of Aarhus organised by the Danish Agriculture and Food Council.

The council works closely with the IFU and will have an advisory role in the fund, according to Egerup.

IFU is now setting up a working group alongside government officials to identify investment opportunities.

"The focus will mostly likely be in processing companies, meat/poultry processing, dairy production, aqua-culture and logistics, including warehousing and silos, because there are a lot of opportunities relating to these sectors in Africa," said Egerup.

The group will also negotiate terms with potential investors and work out the types of returns the fund will pursue; a return target will be announced at a later date, according to Egerup.

The fund is likely to have a three to four year investment period with an extendable 10-year term.

The fund was launched as part of a government initiative to contribute to green growth in developing countries by creating investment opportunities and mobilising institutional capital, said Egerup. And it is pursuing a similar model to the recently-launched Danish Climate Investment Fund that launched earlier this year.

IFU has co-invested into 812 projects in 88 developing countries, according to its website. Commitments now total more than Kr115 billion, of which IFU has committed Over Kr10 billion. And this has helped to create more than 350,000 jobs in the host countries.

IFU is fund manager for various funds including the Arab Investment Fund; the Danish Climate Investment Fund; IØ, the Investment Fund for Central and Eastern Europe; and IFV, the Investment Fund for Emerging Markets.

Christian Super approaches agri with caution

Disappointed by the performance of its first agriculture fund investment, Christian Super, the A$850 million ($798 million; €575 million) Australian superannuation fund, is keen to pursue a more geographically diverse, larger scale and longer term strategy if it returns to the asset class, according to Tim Macready, chief investment officer.

Christian Super in 2010 committed A$10 million to the A$150 million domestically focused Sustainable Agriculture Fund, managed by Australian Farms Fund Management. The GP has now rebranded to AgCap after a management team overhaul, in the wake of poor performance that amounted to an average annual return of 1 percent since launch, Macready said.

'Style drift', or the changing of investment strategies during the life of the fund, was part of the problem, according to several LPs who also said on-farm management practices and bad weather events contributed to lacklustre returns. "Weather risk ... is a natural risk to take in this sector, and without traditional financial markets risk, we are happy to take it on," said Macready. "But the fund never got the scale of diversification it needed to cope with bad weather events in certain regions."

"If and when we look at another agriculture investment we will certainly seek more geographical diversification and scale," said Macready. "Scale is needed in this space perhaps more than in others to get assets of a big enough size of run economically and provide protection. We are not sure whether we will stay in Australia or buying something overseas."

Investing overseas would not be straight forward, however, he added. "Offshore investments can be tricky for us because of the cost of hedging the currency exposure back into Aussie dollars, which can be significant the further afield we go," said Macready.

His team will also look for funds that endure over a longer time frame than Sustainable Agriculture Fund's seven-year life, as, "I suspect that is not long enough to get decent returns", said Macready.

However, he's upbeat about the changes John McKillop, AgCap's new managing director as of August 2013, and his team are implementing, such as selling some of the Sustainable Agriculture Fund's non-core assets and using the cash flow to increase the size of its farm aggregations. And the farmland has not lost any value.

But he will still look more carefully for certain characteristics if and when they invest again. The fund will even consider overseas investing, he told *Agri Investor*.

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> **Tim Macready, chief investment officer, Christian Super**

we will stay in Australia or buying something overseas."

Christian Super has a 2-3 percent allocation to agriculture within a more general 6-7 percent real assets allocation that includes infrastructure, clean technology and public-private partnerships. The AgCap fund investment represented 3.3 percent of the fund at the time of investment.

ACM Permanent Crops fund holds second close

The ACM Permanent Crops fund held a second close in February on $124 million, according to a Securities and Exchange Commission filing. It is targeting $200 million.

The fund, managed by Agriculture Capital Management, has also made its first investment, the $19.5 million acquisition and development of 1,000 acres of blueberry and hazel orchards in Oregon.

It attracted commitments from Aether Investment Partners for $62 million and University of Oregon for $12 million for the first close in January, and Washington State Investment Board for $50 million for the second close in February.

The own-and-operate, fully integrated fund is targeting high value crops — citrus, berries, table grapes and nuts — in the west of the US. It will grow them and package, process and store them in a fully integrated model.

The fund was launched in association with Equilibrium Capital, a real assets fund manufacturer and distributor. Equilibrium helps third parties to launch new funds and distribute them.

Equilibrium declined to comment on fundraising, citing SEC marketing regulations.

AgCap leases cropping land from Westchester

AgCap, the investment management firm of the A$150 million ($139 million; €101 million) Sustainable Agriculture Fund (SAF), has leased 4,200 hectares of cropping land from Westchester, the agricultural asset management company.

The three-year lease is for land near Lake Bolac in Victoria, Australia and will complement similarly held land in SAF's portfolio, according to John McKillop, managing director of AgCap.

"We will be growing wheat, barley and canola on the land leased from them, which is the same as we do on the country owned by SAF nearby," he told *Agri Investor*.

"The same management will cover all of the properties so we are able to scale up quickly through the use of contractors for planting, spraying and harvesting. We have not off-loaded any properties in this aggregation and do not intend to do so, as this region has some of the highest crop yields in Australia."

Westchester has more than $2 billion of assets under management over 40 states in three countries, according to its website. It was majority acquired by TIAA-CREF, the pension provider and financial services firm, in September 2010.

"This is a good example of two large corporate investors working together to fulfill their strategies," added McKillop.

AgCap also manages $350 million for Cubbie Station, Australia's largest cotton grower.

New Forests plan Eco Products first close

New Forests, the timberland asset management firm, is aiming to close its Eco Products Fund for the first time during the third quarter of this year, according to David Brand, founder and chief executive of the firm.

The US-centric fund is targeting $200 million in total and New Forests is currently in talks with around six investors that are doing due diligence. They are family offices and endowment funds, said Brand.

The fund will purchase forestry and wetland assets with the purpose of selling carbon credits and wetland mitigation credits to large corporations such as oil companies and highway construction companies that are required to own a certain amount depending on the development in question.

"Mitigation banking is quite a big business now," said Brand. "The clear water act stipulated that there must be no net loss of wetlands and other aquatic systems in the US so companies seeking development permits must agree to mitigate their impact on such land and this has created a market for ecosystem restoration in the US. It is highly profitable."

New Forests will buy land and restore it into natural wetland systems by returning streams to their normal flow, and ripping out concrete, for example. The land is then accredited by the government as a number of units of restoration which New Forests can then sell on to a developer.

"These developers have no other mechanism of reducing their impact so this is a big market," said Brand. Wetland mitigation credits can vary in price from $6,000 an acre to as much as $300,000 an acre, he added. "You can be very profitable if you are disciplined about doing work well and in the right market — it is highly bespoke for each region and the wetlands have to be restored into the right water system."

Holding these credits, New Forests has five mitigation banks across Indiana, North Carolina and Texas and the firm is looking for more to invest into in the US. There are 1,200 of these banks operating in the US and New Forests will "act as a consolidator to buy out some of them and convert them into proper management farms", said Brand.

Around 30 percent of cases will be greenfield projects where New Forests will need to do all the development work, but in other cases New Forests will ask as a liquidity provider by buying existing wetland credits taking on less risk for higher return, according to Brand. "This will be how we bulk up the business," he added.

New Forest will pursue a similar strategy with carbon credits. It has recently helped an Indian tribe to transition to a conservation management approach to their land, enabling it to release carbon credits for sale.

"The ecological restoration market is worth around $1 billion and is growing 20 percent each year," said Brand.

In focus: Pricing advantage?

Southeast Australian dairy farms are starting to look increasingly attractive to investors due a pricing gap with similar farms in New Zealand, fund managers tell *Agri Investor*. But the degree of interest among them varies. Here a range of fund managers give their views on the topic and the opportunities the region's dairy industry does, or does not, provide.

"We expect the pricing gap between Southeast Australia dairy farms and like-for-like farms in New Zealand to close fairly soon so we want to make the most of this opportunity as soon as possible. Australian farm values are depressed due to large amounts of leverage on their books which we will recapitalise. There is also upward pressure on the global milk price due to rising Asian demand and supply constraints in Australia and New Zealand which means that exported Australian milk is likely to be sellable at European and US prices providing attractive returns."

Stuart MacDonald, managing director, Aquila Capital

"New Zealand's efficiency in dairy production is well recognised, as much as anything it is an attitude towards success in the dairy sector. We see a similar "can do" attitude emerging in the Tasmania industry and believe that with the assistance of the milk processors and sensible investment, Tasmania will become a significant low cost producer of high quality dairy products over the coming decade."

John McKillop, managing director, AgCap

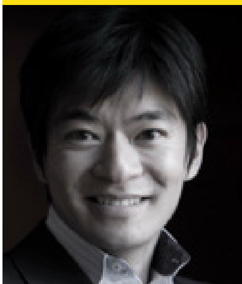
"There are reasons why Southeast Australian dairy farmland is priced a lot lower than similar New Zealand farmland including less cooperative weather and an expensive labour force. The Australian market is much more fragmented too whereas New Zealand dairy farms have the benefit of the world's largest dairy processor – Fonterra. We think that South Australian dairy farms are a good investment opportunity especially as debt pressures generally provide good buying opportunities, but we don't think we will lose out if we wait a while longer to take advantage of this opportunity."

Reza Vishkai, head of specialist investments group, Insight Investments

"At present we are focussed on the beef-cattle sector in preference to dairy. We find the demand and supply dynamics more compelling given that it is difficult to see a meaningful increase in the beef supply in the short to medium term."

Tim Hornibrook, head of Macquarie Agricultural Funds Management

Khosla talks agtech investment



Andrew-Chung

Khosla Ventures, the California-based venture capital firm, has been investing in agriculture and food technology for some years. Here Andrew Chung, partner at the firm, explains how sectors fit into the firm's overall investment objectives and capabilities. ***Andrew Chung,*** *partner at Khosla Ventures*

When did you first start investing into agtech and food technology?

About five years ago when many other venture firms were not yet comfortable taking the risk. We pride ourselves on looking at spaces when others are not; leading the herd as opposed to following it. We now have 10-12 investments spanning new food production Hampton Creek, ag biologics BioConsortia, agronomic data Climate Corporation and robotics and precision ag Blue River Technology.

How does the sector compliment your other focuses?

There is quite a bit of overlap between the ag space and the energy sector. In both cases you are addressing a global infrastructure problem. There is demand for both food and energy that exceeds supply and in both sectors there are companies developing techniques to use the resources available more efficiently. Khosla was founded on a thesis to identify "black swan" technologies that can change the world's infrastructure for the better, and agri certainly fits that criteria. And many of the issues at hand are particularly important in the developing world. This is why we lump energy, food and agri together under the banner of 'sustainability'.

What are the challenges of investing into agtech and food tech?

Both are heavily regulated industries where policy is important and variable across geographies so a deep understanding of these areas is necessary. Startups in this area compete against large incumbent players that have significant investment in the sector, massive distribution capability, and have been around for years. The sectors also involve very long-term horizons for validation and commercialisation.

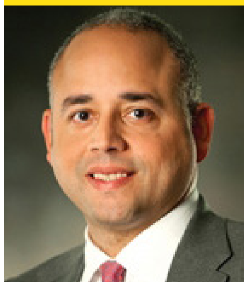
How is Khosla positioned to cope with these challenges?

The way we have designed our fund structure enables us to play in the very early stages in startups through our $300 million early stage seed fund. This can literally fund experiments to see whether an idea or technology has legs. It is very risky but when these initial projects bear fruit, we can start the clock again and invest through a $1 billion main fund. This dual-fund structure means that it does not matter whether it takes several years to get initial validation or attract high quality senior management.

Are the other investors you are coming across in these spaces from a similar pool?

There is some overlap, but everyday investors seem to be more excited about the food side of things. It's easier for most investors to relate personally to advances in food technology as opposed to the complex technologies in agricultural production side. That said, some of the big agri data businesses have had interest from IT investors. Climate Corporation was the poster child of that segment, with its recent $1 billion acquisition by Monsanto.

TIAA-CREF's Minaya offers advice



Jose-Minaya

***Jose Minaya,** head of Natural Resources & Infrastructure Investments at TIAA-CREF, gives first-time investors advice and talks about the benefit of buy-and-lease farmland holdings.*

How has agri investing changed since you started looking at the asset class in 2006 and where is it now?

It has changed dramatically. Back then there were maybe a few people asking questions and now over 700 will attend conferences dedicated to the topic. While there are more investors looking at it, there is still a big gap between interest and actual investment. There are tremendous barriers to entry; agriculture investing looks like real estate investing did 30 years ago.

What are the barriers to entry and what needs to change?

The biggest barrier to entry is the lack of information. We need to bring more transparency to investors. How can you gauge the return profile of farmland? The NCREIF farmland index is a good one but it's not truly representative of the whole market. When trying to do data analysis to find out if this asset class does what an investors wants it to do, it is very difficult with the information currently available.

The industry's lack of a track record is also an issue but investing with a new manager is not impossible.

Would you recommend any regions or sectors to first-time agri investors?

Our goal is to get exposure to the global theme of inelastic demand for food and the inelastic supply of it. But I don't think I would recommend any specific strategy to everyone. My advice would be firstly to identify what exposure you are looking for. There are many different ways you can invest into the agriculture space and they can all be played in different ways. Are you happy with a long term asset or do you want to take a shorter term view? You need to be comfortable with the risk return profile ratio too.

Secondly pick a management team that is locally-based with local experience and expertise – agriculture is an extremely local business. We do not manage it from New York; we have a presence in every market we are invested in.

You are a buy-and-lease investor for the most part. In what incidences do you operate the land too?

In countries where the tenant base is not as developed as elsewhere it is important to operate the land yourself to ensure it is as productive as possible. Permanent crops such as fruit orchards are another area because over 50 percent of the value resides above the ground and you can engage in contracts with off-takers to manage pricing risk. But in general operating the land adds more risk and volatility to the investment because there are more variables, such as labor, consumer preferences, and potentially large operating losses in any given year complicating the thesis.

Private equity investing into the value chain is attractive. It is a higher risk than investing in land but given our [scale and access to] information about the market, we believe we can generate better risk adjusted returns in the sector. For example, we are one of the largest almond growers in the world so when we started investing in almond processing companies it was a completely different experience to others investing there purely as a financial buyer. Everything that grows on our properties needs to be processed, packaged, stored and transported.

TIAA-CREF is known for its dedication to following ESG principles but how do you ensure this?

First, TIAA-CREF partnered with a group of institutional investors to establish the Principles for Responsible Investment in Farmland. These principles provide guidelines to responsible investment and management of global farmland. We ensure consistency with the principles by employing a rigorous investment approach that includes a number of policies, procedures, and checklists that assess, mitigate, and manage risks. For example, we conduct an environmental site assessment for all farmland purchases to understand the baseline condition prior to acquisition. We leverage our internal engineering team at TIAA-CREF to assist in this evaluation as well.

Macquarie's Hornibrook talks track record

Tim-Hornibrook

*Macquarie Agricultural Funds Management's head **Tim Hornibrook** discusses the development of the agri-investment market and the importance of developing a track record.*

How has demand for agriculture assets changed in the past few years?

I think the whole economic crisis provided people with the imperative to start looking outside the normal mix of assets for new sources of returns that would be uncorrelated to traditional assets.

There has definitely been a pickup in actual investment, albeit coming off a low base so it is not meaningful yet. The majority of interested investors are still sitting on the side-lines and will continue to do so until asset managers can demonstrate a track record in the asset class.

How long do you think this will take and what does a track record need to look like?

As a comparison – private equity first started to appear as an asset class in the 1970's but really didn't start to gain broader acceptance until the early to mid-2000s. In agri I think there are a handful of managers out there that are starting to build a track record, but the sector is still a few years away from a track record that will be accepted more broadly by institutional investors.

It definitely helps if you've managed more than one fund. Showing divestments also will assist because at this stage in the life cycle of the asset class, exits are mostly conceptional given most managers are relatively new to the sector.

How does the issue of asset class classification impact demand?

It is always easier to adopt a new idea when it fits neatly into an existing box. The 'real asset' bucket is a more recent creation that doesn't feature in every institutional portfolio. Without a real assets sleeve investors will need to look at the asset manager's strategy. Buy and lease investments are closer to real estate, whereas own and operate assets have elements of real estate, private equity, and natural resources or commodities. The investors in our Pastoral Fund which closed in 2011 tended not to have specific allocations to meet, but were looking for ideas that worked relative to the existing investments in their portfolios. Those investors would definitely be recognised as early adopters of new investment ideas.

Why have so few institutions committed to the asset class yet?

When an institution it trying to educate itself on a sector, anything that might seem unusual can be a reason not to go ahead, this includes ownership regulations, politics and potential reputation risk. But these are apparent in all asset classes within a portfolio, it's a matter of understanding them in the context of each particularly asset class and jurisdiction. In mining for example, in Canada you cannot be a majority owner but foreign mining companies still invested there because the opportunity was attractive and they developed structures that gave with exposure. Understandably, when going into a new asset class investors want to avoid 'red flags'. However, the supply/demand imbalance that exists in agriculture and the fact the sector needs to attract outside sources of capital to invest in productivity initiatives, combined with it being an under-invested asset class from an institutional stand-point, means agriculture is an attractive investment opportunity.

Agriculture fund offerings have been around for a few years with limited success – what's changed?

It's true that some funds have come and gone over the past few years. I think some investment managers got caught on the idea without really understanding what was required to manage assets in the sector or how difficult it would be to raise money for a new asset class. But thanks to ongoing education, there are a large number of investors that now have a better understanding of the sector, the associated risk and how those risks are managed, and the management firms who have endured are starting to build track records.

Agri REITs will mobilise the masses

John Baker

John Baker,* *chief executive of First Agriculture Holdings, tells* ***Agri Investor *why he has decided to go down the agri REIT route.***

One of the biggest challenges to investing in agri today is liquidity, argues John Baker, chief executive of First Agriculture Holdings (1AG) and previous Asia head of food and agribusiness research and advisory at Rabobank.

"When I talk to sophisticated investors about investing in things like agri land, one of the major investor issues is liquidity," Baker told *Agri Investor*. "If you don't have that, it changes the whole risk prism through which sophisticated investors view the investment."

It is for this reason that Baker launched 1AG and plans to list a $500 million real estate investment trust (REIT) on the Singapore stock exchange in the next few years.

"I had a vision of creating new investment pathways for funding to find its way into the agribusiness sectors as I could see that there were some constraints," he said. "Food and agriculture is not exactly a mainstream investment class today, which is mostly driven by a lack of familiarisation with agri related risk. However, I am confident it will become mainstream one day."

Baker believes that a REIT, comprising of buy-and-lease investments across the supply chain from agricultural land to ports to storage and processing, will make the asset class more investable. Having assets with a similar earnings capability — from rent — will also help to correlate them more closely.

He also argues that a buy-and-lease model is better able to connect the risk and reward of an investment because the leasing value of land can be directly influential in its overall value. By comparison, own-and-operate land investments can suffer from low cash returns during their life and in some instances the land value does not appreciate enough to provide an attractive kicker.

"The argument around the equity return gap is usually justified by the non-cash equity growth the investor would receive as the land appreciates over time," he said. "That's where the problem starts. In Australia, agricultural land values have generally fallen since the global financial crisis, which has caused the equity returns of many investments to struggle in satisfying return hurdles expected of investors."

"If REITs and other similar sale-and-leaseback structures begin to become more prominent in the ownership of agricultural land and other agribusiness assets, and we are starting to see more and more evidence of this, then earnings based valuation models for agricultural land in particular will become more commonplace. The change and acceptance of this valuation methodology is key to attracting larger fund flows from mainstream sophisticated investors. If this occurs, I am confident that agriculture land ownership can become a mainstream investment class," added Baker.

Before joining Rabobank, Baker worked in the asset management industry in Deutsche Asset Management's complex assets group. But he is uncomfortable with the '2 and 20' fee structure that many private equity funds charge. "I am just not sure it is suited to the agri land asset class," he said, as other asset managers have told *Agri Investor* in the past.

Baker therefore launched 1AG in 2012, an investment holding company based in Singapore, and brought two investors on board — Hemant Bhatt, former chief executive of Louis Dreyfus Commodities and Halcyon Strategic, a member of the Halycon Group which operates a Singapore-listed rubber processor with operations in Indonesia and Malaysia. Together they make investment decisions.

And Baker is open to new investors in 1AG should they fit the profile.

"Our motto is to keep things simple and straightforward," he said. "Our prima facie focus initially was not the retail investor, although I believe that in order for agribusiness to flourish it must find a way to tap retail funds, and ultimately become a mainstream investment class."

The holding company is now looking for invest-

"Food and agriculture is not exactly a mainstream investment class today, which is mostly driven by a lack of familiarisation with agri related risk. However, I am confident it will become mainstream one day."

ment exposure across the entire agri value chain, in Asia Pacific, to put into a REIT; assets that it can lease on to farmers with illiquid balance sheets and intermittent cashflows and onto large well-capitalised supply chain managers, retailers and processors that have much stronger cash flow business models.

"Investing into a self-reinforcing blended supply chain risk could make agrifood investment more attractive compared to a pure farming investment play," said Baker.

But the REIT will need to be at least half a billion dollars to work, according to Baker. "With REITs you need to start with a scale portfolio, which differs from other investment approaches to agri investing that centre around aggregation over time."

Creating a REIT of this size will require a lot of coordination as the deals will need to be executed at the same time. And this could take some years to organise, warned Baker. There will also be the external risks associated with competitive bidding processes and other external factors; there are a lot of caveats, he added.

Listed agribusiness funds have not had the best reception in the past, sources have told *Agri Investor*. Is this a worry for Baker?

"Trading liquidity is a concern but this is why you need to start with a very large asset portfolio. Large scale agri REITs do not exist today and certainly smaller vehicles will probably struggle with liquidity. But we remain convinced that there is room for a large scale agri food REIT."

Baker is not totally adverse to the private markets and will be concurrently searching for private equity investments to be made by the holding company; the holding company will also have a stake in the REIT and own the management company.

Baker has also worked at Louis Dreyfus and the Australian Agricultural Company during his 18-year career in food- and agribusiness-related mergers and acquisitions, private equity, and research and advisory disciplines.

Editor's letter

The resilient almond

The drought challenging California farms and orchards illustrates that agri investors' choices aren't always black and white

When it comes to investing in agriculture, everything is not always as straightforward as it seems.

Take, for example, California's almond orchards, which supply more than 80 percent of the world's almonds. Investing into those at the moment – when the Golden State's drought has been declared a state of emergency, and local, state and federal politics over access to irrigation complicate the matter – may seem like madness. A farmer that would usually pay around $10 an acre for additional water has been paying as much as $2,000 an acre, according to local real estate agents. So to say that some of them are struggling is an understatement.

But it's not so simple, says the chairman of one European family office. Earlier this week he told me the family office was considering selling its investments in Californian almond orchards due to uncertainty about the drought situation. "Is this is a short term effect or related to global warming? We just don't know and it is difficult to take a position on that," he said.

In the same breath, he told me that the office's 10-year investment into the orchards had to date produced a 20 percent internal rate of return, thanks to land values increasing 2.5 times over the period (which has included dry spells) and 6.5 percent annual production returns. The orchards have also produced a full harvest recently despite the drought.

Even if Californian almonds are getting more expensive to cultivate, prices are generally expected to rise in parallel due to the region's near monopoly in production, making the Californian almond market seem relatively resilient to the impact of drought. Especially when you consider that land values continue to grow sharply. Demand for the state's prime agricultural land is so strong that one asset manager focusing on the region told me he conducts most of his business secretly to ensure no one else gets wind of assets in play.

"For every one person wanting to sell – there's 100 wanting to buy," Phil Christensen, founder at Agri Globe, the Californian agriculture asset manager told me.

So drought is not really deterring investors, although water access is of course affecting land prices. Tom Lindemann of Lindemann Properties, which specialises in the sale of California ranches and farmland, noted that he's brokering the sale of one parcel at $22,000 an acre with two acre feet of surface water already purchased for the 2014 harvest; whereas another parcel with access to more water in dry years is going for $30,000 an acre.

California's current water challenges – and its almond crops in particular – serve as a reminder that with proper due diligence, some very smart agri investments can still be made in the face of – and perhaps even profit from – adverse agricultural conditions. Drought doesn't necessarily mean disaster.

To lease or to operate?

Institutional investors may be increasingly attracted to funds touting operational agri expertise – but that doesn't mean they should disregard buy-and-lease models, especially in developed markets like Australia

Since we launched *Agri Investor*, I have had various conversations with managers and investors about the buy-and-lease investment models versus own-and-operate opportunities. While the former is a more traditional, real estate-type method of getting exposure to farmland and agriculture, the latter has prompted excitement from the investment community due to the inherent control over the asset that it entails and also the large returns on offer.

But buy-and-lease investments are still very relevant and can be exciting, particularly in developed markets such as Australia where there appears to be a boom in the land lease market. Whether you are an investment manager or an end investor, it is worth keeping abreast of developments here as several buying opportunities are likely to emerge with a vast pool of potential lessees available to manage land.

The buying opportunities are most likely going to come from the generational shift that is happening in the farming community. Whether this is a farmer planning his retirement and deciding to release capital from his land, or a young inheritor unable to afford to upgrade and improve his land, wishing instead to sell it and lease it back, land is up for sale.

Land aggregation is also increasingly important in Australia where farm operators are trying to feed growing demand for food from Asia and this is where the source of lessees is coming from; large farming corporations or families wanting to increase production.

Australia's agriculture industry needs foreign investment to help this corporate farming industry develop and take advantage of that Asian demand and the buy-and-lease model sits well with locals who are largely maintaining their jobs on the land just perhaps under foreign ownership.

Matching the buyer to the seller and lessee will require some local knowledge and there are some local firms popping up to fill this gap such as National Land Lease. NLL will work with investors on direct investments but can also help investment fund managers find farm properties to lease.

Investment management firms are also providing a similar service such as the Australian Investment Development Corp (AIDC) that recently handled a direct $10 million buy-and-lease investment for a Swiss private investor into a cattle ranch in Queensland. AIDC is also planning to launch a fund that will mimic this style of transaction.

On the investor side, committing to buy-and-lease farmland funds – or indeed doing direct buy-and-lease deals themselves – is a relatively simple way of gaining agriculture exposure without needing operating expertise in-house, or through a local partner. It is also a popular tried-and-tested method among existing agricultural investors — not least TIAA-CREF, the US's largest private pension fund and an agri-investment trailblazer that has both backed fund managers and dabbled with direct investment in the buy-and-lease sphere.

As Jose Minaya, the pension's head of natural resources and infrastructure investments, told us in his Point of View interview featured in this Compendium, operating land, whether through a direct investment or fund commitment, makes risk factors such as labour costs, commodities prices and the weather far more pronounced.

Bearing these risk factors in mind and the availability of high quality farm operators to lease land in developed agri markets like Australia, buy-and-lease funds should be considered attractive and easy-to-understand investment prospect, particularly for first-time agri investors.

Australia is not the only market to watch. Canadian farmland values are hugely on the up and increased 22 percent on average in 2013 according to Farm Credit Canada. Investing a large amount of capital into operating land that itself has great upside potential seems unnecessary.

The opportunity for funds of funds

Louisa Burwood-Taylor, Editor, *Agri Investor*

As the diversity of agri funds grows, and the credibility of their management improves, there is an opportunity for a thriving fund of funds market to mobilise institutional investors

Nearly every day I come across a new agri fund or investment opportunity offering something slightly different to the one before it. Whether it's dairy farming in Australia, crop farms in Africa or coconuts in Brazil, there are unarguably many different ways to invest into agricultural land.

The wealth of different sector-specific agri funds on the market at the moment, and the inevitable supply of secondary agri investments, means there will be an attractive market for funds of funds to launch in the asset class.

And this is not only on the supply side – for many institutions that are unable or unwilling to develop an agri investment team in-house, the diversified play that a fund of funds would provide could be very appealing.

An example of this is the launch of Liquid Investments' coconut and neem fund in Brazil. The fund is focusing on attracting family offices and high net worth individuals first, as many funds are, because these investors can be more nimble in their investment decisions and are more willing to take niche bets.

Institutional investors of the public pension ilk have many more boxes to tick however, and investing into such a specific play would be too risky unless they could pursue other sector-specific funds in their portfolio. But to develop an agri portfolio in-house requires experience and knowledge of the asset class. For many institutions it is too soon to go down this road – and some remain wary after having made lacklustre timber investments in years past.

A fund of funds makes the investment proposition much more a question of analysing the management firm rather than the agricultural product. And this is more familiar territory for many CIOs and their advisors.

"It is a bet on the selection process," an investment banker told me this week. Rather than taking a specific view on coconuts you are taking a macro view of demand and supply fundamentals in agri, population growth, consumption trends and so on. "It's a much easier approach," he added.

Some of the more sophisticated investors will prefer to invest more directly, loathe to pay another layer of fees that a fund of funds will imply, a US placement agent told me. But for first-time institutions it's a great place to start.

Insight Investment now runs a $100 million-plus globally diversified agri fund – another good option for first-time investors – but it started its agri life with a fund of funds that it launched marketing for a week before Lehman Brothers collapsed. This event allowed the firm to change tack as it had already come across problems in finding suitable funds – a common theme of conversations has been the dearth of "institutionally credible funds", as the placement agent called them.

Until just recently many agriculture funds were managed by ex-bankers with no agriculture experience, trying to get in on the latest trend and charging high fees for the privilege, which has been partly responsible for the asset class's stuttered existence.

But the agri fund market is becoming much more realistic. In most cases a finance professional is partnering with a farming professional and this marriage, or "common mistrust" to again use the placement agent's words, is attractive.

A thriving fund of funds market will also create a bustling secondaries market that will in turn improve the chances of primary funds getting the exit that many investors worry about. The opportunity to buy a portfolio of developed agri assets will also mitigate the J-curve effect implicit in many greenfield, or transformative, agri strategies.

All in all, the development of an agri fund of funds market will be no bad thing and could perhaps help mobilise the asset class faster.

agri investor

global agri-investment intelligence

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Agri Investor is the dedicated source of insight and intelligence for private investment in agribusiness and agriculture globally. It is relevant to institutional investors, asset managers, advisors and operators focused on agri-investment.

In our definition of agri we include farmland, timberland, agriculture and food technology, food processing, storage, water and all agribusinesses in the value chain.

Our online news coverage will deliver fresh reporting on the firms, the people, the deals and the data that are driving these communities and also showcase hand-selected, third-party commentary and research from industry thought leaders.

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