



# agri investor

*global agri-investment intelligence*

## Harvesting new opportunities

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# Agriculture's yellow brick road

The rationale for investing in agriculture and related businesses can be read on the pages of an increasing number of newspapers, whitepapers and research documents as the implication of limited land resources and a growing world population becomes clearer.

Food security is a term on the lips of many diplomats as it is predicted that agriculture production will need to grow by 60 percent by 2050 to meet global demand, according to FAO. This makes investment into land not the only attraction; the businesses, technology and services that are needed to improve the productivity of the industry as whole are also increasingly in view.

Investors' need for reliable, strong returns is another motive causing them to consider agriculture in addition to more traditional asset classes, as Evelyn Lee discovers on page 10. As interest in the sector gains traction, however, the methods of investing in the agriculture story are becoming increasingly diverse.

Farmland investments, once treated as simple real estate transactions, are starting to look a lot more like private equity deals not just because of the players involved, but because many buyers are taking more operational control and seek to add value (see page 5). Some fund providers are taking things a step further and offering vertically integrated funds that provide exposure to agribusinesses further up the value chain as the phrase "farm-to-fork" becomes ever more relevant.

Silicon Valley, for example, is buzzing about developments in agricultural technology as farmers start to think more carefully about how to work their finite land resource in an effective yet sustainable way. Venture capitalists have said that they hope advances in agtech and precision farming technology will help to shatter the illusion that the globe's existing farmland cannot feed the world population well into the future – and they are embracing the sector.

Timberland investing is also still very relevant as perhaps the most conservative approach within the broader agri sector. Forestry can provide a relatively stable and income-generating option even in volatile market conditions. The more trees grow, the greater value they hold. As one timber investor explained, they "store on the stump"



leaving little downside risk in the face of low demand; he later joked "trees don't read the Wall Street Journal"!

With an increasing number of ways to get exposure to agriculture (and let's not forget investors still make good use of public equities, too), management firms now need to educate, educate, educate. Many institutional investors have made allocations to the asset class in some way but a good number remain on the side-lines waiting for an opportunity that suits them. Lacking familiarity with the asset class among investment board members is a big problem (see page 11).

How to classify agricultural assets can also be challenge for both investors and management firms.

A typical buy-and-lease farmland investment would fit quite neatly into a real estate portfolio but as investments into operations grow they take on a new guise, in some cases attracting the attention of an institution's private equity team (see page 5).

Increasingly however, consultants are suggesting that investors make room for a real assets portfolio that can include allocations to agriculture. And this relates to a more general trend to increase investments into real assets. Aquila Capital, a real assets manager, recently surveyed 54 European pension funds of which nearly 60 percent said they planned to increase their exposure to real assets over the next three years. Timberland accounted for 18.4 percent of this and farmland 2.6 percent.

Challenges such as classification will not disappear in a hurry — it is a long road until agriculture becomes a staple investment for institutions. But as the market develops and best practices among both investors and fund managers are established, Agri Investor will be there providing analysis and insight as we track the institutions, funds and transactions shaping the global agri-investment markets. This compendium is just a taste of what's to come.

Happy reading,

*Louisa Burwood-Taylor*  
Editor, Agri Investor

# THE WORLD IN AGRI

*A snapshot of recent agri-investment news from around the world*

## CANADA

### Bonnefield closes Fund III

Canadian farmland asset manager Bonnefield has closed its third fund on C\$261m (\$235m; €172m), beating its C\$200m target and raising more than its C\$22.5m Fund II. The fund focuses on row crop farms in Canada and operates a buy and lease strategy.

## SASKATCHEWAN

### CPPIB buys farmland portfolio

CPPIB bought a farmland portfolio from Assiniboia Capital Corp, a Canadian agriculture investment company, for C\$128m (\$115m; €84m). The deal represents CPPIB's second foray into agriculture. Assiniboia will continue to operate the land.

## WASHINGTON

### WSIB goes further into agri

WSIB approved two new agriculture investments: a \$250m separate account investment with Wood Creek Capital Management, a real assets manager based in Connecticut, to invest into between seven and 10 agriculture-related midstream assets; and a \$50m investment into the ACM Permanent Crops fund, a vertically integrated fund managed by Agriculture Capital Management in the US.

## US

### US potential

In the US alone there is \$1.8tn worth of farmland potentially up for grabs, according to the Oakland Institute.

## CALIFORNIA

### Crowd-funding platform launches

AgFunder, the online fundraising platform, launched its first investment; a \$400,000 convertible note for OnFarm, the agriculture data technology company. Commitments reached \$230,000 after the first day.

## BRAZIL

### Liquid to launch Brazil fund

Brazil is increasingly on the mind of agriculture investors worldwide. London's Liquid Investments is preparing to launch a \$250m fund in July to invest into coconut and neem plantations. The firm will work as part of a JV with Cohibra, the country's largest plantation management firm.

## BRAZIL

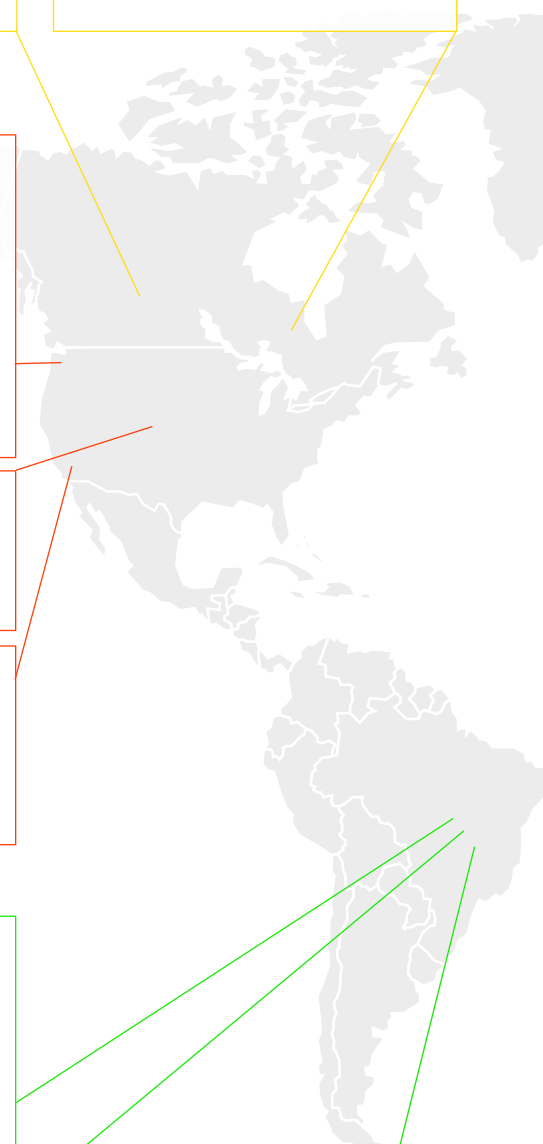
### Cordiant finances Brazilian agribusiness

Cordiant contributed \$10m to a \$100m financing facility for Fiagril Participações, a major supplier of seeds, fertiliser and other materials to Brazil's agricultural industry. The deal was made alongside global agriculture group Bunge.

## LATAM

### LatAm fund targets \$300m

SIP LATAM AGRIFUND is targeting \$300m with a \$500m hard cap, to invest across Latin America. It is targeting an IRR of 10-14 percent over its 10-year life. The fund sponsor is Sherpa Asset Management, the family office of chairman Gilles Plaquet.



**UK**

**UK borough mandates WP Global**

Royal Borough of Windsor and Maidenhead Pension Fund has mandated WP Global Partners in Chicago to find private equity investment opportunities in companies that operate and have exposure to the food and water value chain. This could include companies supplying seed and rootstock, aggregators of small farm operating companies or weather technology companies.

**SWITZERLAND**

**Adveq buys Olam's almonds**

Swiss fund of funds house Adveq bought 11 almond orchards from Olam in Australia for A\$211m (\$190m; €139m) alongside four institutional investors in February – one of the largest farmland transactions in the last 12 months. The firm has established a co-investment platform alongside its \$300m agriculture fund.

**EASTERN EUROPE**

**Five firms start fundraising**

Five management firms have launched, or made plans to launch investments in the Eastern European region. They include newly formed joint venture Trigon InvestAg; UK-based Mintridge International; KinnAgri; Brown & Co's JV with Dexion Capital Management and Rabo Farm.

**HONG KONG**

**Alts fund manager considers agri**

Orion Partners, a real estate and private equity investment firm based in Hong Kong, is considering launching a global agriculture fund later this year. It will take on both real estate and private equity opportunities in agriculture.

**AUSTRALIA**

**Aquila launches dairy fund**

Aquila Capital has launched a seven-year fund dedicated to investing in distressed dairy farms in Southeast Australia. The fund aims to raise \$400m by Q3 and to deploy all the capital within 18 months of closing.

**NEW ZEALAND**

**Ecological fund nears 1st close**

Agro-Ecological is nearing the first close of its NZ\$300m (\$256m; €186m) New Zealand-based agriculture fund that will focus on investing into dairy, beef, lamb and venison farms creating an agro-ecological environment to boost performance and produce organic products.

**INDIA**

**Omnivore considers Fund II**

Omnivore Partners, the Mumbai-based venture capital firm, is considering launching a new agriculture-related fund in 2015. Its first \$40m fund is now 40 percent deployed.

**SOUTH AFRICA**

**Agri-Vie I nears full deployment**

South Africa's Agri-Vie, a food and agribusiness investment fund house, bought a \$5m stake in Kenyan flower exporting business Kariki Group; the penultimate investment for Agri-Vie I. Agri-Vie II's first close is expected in the middle of the year.

**AFRICA**

**FAFIN completes 1st close**

FAFIN announced its first close of \$34m in January of which the Nigerian government committed €10.5m directly through the Federal Ministry of Agriculture and Rural Development ("FMARD"). Management firm Sahel Capital invests into small and medium-sized enterprises across the agriculture value chain in Africa.



# Fresh pastures

*An increasing number of private equity and alternative investment managers are getting into the agriculture and agribusiness sector(s). But their approach to investment varies widely, finds **Simon Clark**.*

**P**aine & Partners is dedicated to investing in agriculture. But the New York-based private equity firm doesn't buy any land.

"Some have said we need to buy land," operating partner David Buckeridge says. "We never thought that was the role of a private equity firm."

Instead, it looks for profitable ways to invest in companies that are focused on food and agricultural technology. The strategy has transformed Paine & Partners over the past 12 years into an agribusiness specialist from its generalist mid-market roots.

"Our thought is to be in a particular layer ... where you are adding significant value," says Buckeridge. "For example, the malt in beer is a very tiny percentage of the cost of beer but you can't make beer without it. If you are breeding barley genetics for malting quality you can have a big impact on the quality of

the beer. So that can translate into a big return."

To discover new investments, all Paine & Partners' executives meet once or twice a year to discuss new themes. They look at the value chain, from genetics to food processing, and have previously explored themes including precision agriculture, aquaculture, feed ingredients and therapeutic ingredients like omega-3 and DHA. When a new investment idea is found, executives are assigned to analyse it.

"They go away for a deep dive to explore how you could play that sector and who are the movers and shakers," Buckeridge says. "We did that before we ever bought seed companies. The firm ran a deep dive in the seed industry back in 2001 and that resulted in Seminis, sold to Monsanto, and Advanta, which was much more focused on field crops. We broke it into six pieces and sold it to strategic players."



Buckeridge and his colleagues are not unique: a greater number of private equity firms and investors are now exploring potential deals in the ‘farm-to-fork’ supply chain, investing for example in service and technology businesses expected to benefit from the macro trends related to global food supplies, changing demographics and finite resources.

But equally, there are other private equity managers developing strategies and creating new products to acquire land. Swiss private equity fund of funds house Adveq, for example, sees great value in investing into land-based agriculture assets. It’s been raising a dedicated real assets fund, has launched an agri co-investment platform (see box), and recently completed its first deal with the A\$211 million (\$190 million; €139 million) purchase of almond orchards in Australia alongside four institutional co-investors from Olam Australia. The deal involved the leaseback of three million trees and 18,000 hectares near the Murray River in Victoria to Olam.

Meanwhile, other alternative asset management firms are offering the whole suite of investments up the value

**“You could easily argue that the own-and-operate model is private equity. Buy-and-lease is ... far more akin to real estate but you’ve also got to look at whether it can be effectively implemented in different markets”**

**Tim Hornibrook**

chain from investing in the land, to its operation and up into the processing of its produce. One such fund is the ACM Permanent Crops fund, a vertically integrated fund managed by Agriculture Capital Management in the US. The fund was launched backed by Equilibrium Capital, a real assets fund sponsor. Equilibrium identifies strategies and launches funds usually in partnership with experienced operators. It also helps to structure and distribute new funds.

### A NEW APPROACH

Until now, buying land and leasing it to operators has been the most common, and least risky method of investing into agricultural land — and has typically been the domain of enthusiastic ‘alternative’ real estate investors — but there are an increasing number of agricultural asset managers that are taking a different approach to the asset class. They are forgoing the buy-and-lease model for a more private equity-style strategy: buy the land, upgrade it and operate it.

## ADVEQ’S ALMONDS

Swiss fund of funds house Adveq bought 11 almond orchards in Australia for A\$211 million (\$190 million; €139 million) alongside four institutional investors in February. The deal represented its first agriculture investment and the launch of a co-investment platform in the asset class.

The deal was four years in the making after Adveq Real Assets, the firm’s new real assets programme, interviewed over 400 institutional investors to find those with similar views on agriculture investing. “While many seemed to want the same thing, it was difficult to find common ground on the definition of real assets,” Gaia Arnaboldi, co-head of the Adveq Real Assets Programme told *Agri Investor* in February.

“The basis of our platform was to create a deal club where our interests were aligned,” said Arnaboldi. “This includes similar views on sustainability and ESG principles, the types of assets of interest and the amount of influence and control we want over our investments. And this way we can do repeat business and know we can trust one another.”



The Olam deal will now provide the blueprint for other co-investments with Adveq’s Harvested Resources Fund, a 12-year blind limited partnership fund targeting \$300 million and still open. Municipal Employees’ Retirement System of Michigan, Danica Pension, Wake Forest University endowment fund and an undisclosed UK institution co-invested in the orchards and Adveq expects a variety of investors to buy into each deal.

“One deal fits some, but not all,” said Berry Polmann, head of the Adveq Real Assets Programme.

To work out what to buy, Adveq has developed a “matrix” of requirements including return expectations, diversification from the current portfolio, input costs, value chain steps, and ensuring an effective inflation hedge.

“What’s more attractive? Soya beans in Brazil or beef in Australia?” asks Pollman. “We went deep into the value chain of the commodities that looked interesting and took it apart.” ■

Macquarie Agricultural Funds Management in Australia is one example.

“When trying to classify agriculture investments you need to look at how the asset management firm is managing the assets — you could easily argue that the own-and-operate model is private equity. Buy-and-lease is definitely an easier model for investors to get their head around and is far more akin to real estate but you’ve also got to look at whether it can be effectively implemented in different markets,” says Tim Hornibrook, head of Macquarie Agricultural Funds Management.

“In the US there is a large pool of operators willing to lease land whereas in Australia, where the market is dominated by owner operators, you don’t have the same depth of third-party operators who are seeking to lease someone else’s land. Then there are certain countries where foreigners cannot own land such as the Ukraine, meaning that to get exposure you need to lease and operate the land yourself.”

So-called own-and-operate funds will typically offer higher returns than a buy-and-lease fund although these can vary wildly depending on the agricultural sector and geographical location of the investments, according to Hornibrook.

Macquarie closed its A\$800 million (\$728 million; €524.2 million) Pastoral Fund in 2011 after fundraising for four years. The fund invests directly into the beef cattle and sheep industries across Australia although Macquarie’s agriculture business has a much wider global reach and has been active in the sector for over 20 years, according to Hornibrook.

It has agricultural commodities specialists in all the major production regions in the world, is one of the largest providers of agriculture risk products globally and the business encompasses everything from risk management project finance to asset management.

South America-focused SIP Latam Agrifund is another example of a private equity-style approach to agriculture investing. Targeting \$300 million with a \$500 million hard-cap, the 10-year fund was launched by Sherpa Asset Management, the family office of chairman Gilles Plaquet who has a long history of farming in Belgium. The fund plans to acquire farmland across Latin America, from Paraguay to Brazil, improve it and operate it and is targeting a 10-14 percent internal rate of return.

Sherpa has in the past created new farms from scratch,

buying unfarmed land and converting it into working land by using various methods such as improving the soil’s fertility and PH levels. This is a long-term commitment and requires at least three years of land preparation before anything can be grown, but the land can be cheap to buy because it has little farming value at first.

BNY Mellon’s Insight Investment, a specialist investment manager, is another own-and-operate fund manager after changing its agriculture strategy from a fund of funds approach. The firm’s farmland investment strategy hinges on strong in-house expertise and expert local operators.

“We first started fundraising for a fund of funds but the global financial crisis – when investors shunned anything illiquid – gave us time to change our tack,” says Reza Vishkai, head of Specialist Investments Group at Insight Investment, a BNY Mellon company. “After failing to find any attractive funds in which to invest, we decided to refine the strategy so the fund could invest directly using the best local operators. We soon realised that having strong in-house corporate farming expertise was essential in doing so. Farming is a local activity so we identify and work with the best-in-class local operators in each region.”

One such local operator is MyFarm in New Zealand. MyFarm has its own asset management business as well as relationships with Insight Investment, which closed a 10-year globally diversified own-and-operate fund at the beginning of 2013, and Aquila Capital, the European real assets management firm.

### RISKY BUSINESS?

Land investing, whether under the own-and-operate model or a less involved buy-and-lease model, still raises concerns among pension funds and some prefer to gain exposure to agriculture through indirect investments instead.

“We prefer to play the agriculture theme through private equity investment into companies involved in the food chain because we do not feel comfortable with the risks involved in investing into land overseas,” says Nick Greenwood, pension fund manager at The Royal Borough of Windsor & Maidenhead. “There are too many factors at play such as

“We do not feel comfortable with the risks involved in investing into land overseas.”

Nick Greenwood

political changes and restrictions to foreign ownership. There is reputational risk at stake too.”

Land acquisitions in many developing countries have proved controversial, provoking significant protest and scrutiny from human rights organisations. The International Land Coalition’s Land Matrix website has tracked 937 international land purchases since 2000 in developing countries, from Kenya to Brazil, totalling 35.6 million hectares. That’s an area the size of Germany.

“It’s not that we see investment as bad,” says Neil Sorensen of the International Land Coalition, whose members include Oxfam and the World Bank. “Problems happen when corrupt governments just decide that they are going to uproot 5,000 people and sell the land they live on to a company without any kind of due process.”

Buckeridge cites the recent revolution in Ukraine and Russia’s response to it as an example of the political risks associated with owning farmland in some countries. “The land quality is first-class and the scale of farms is large, but it would prove to be a very politically risky investment with a lot of downside,” says Buckeridge, who lives on a farm on Britain’s Isle of Wight. Buy contrast, he points to portfolio company Eurodrip, which “sells its precision irrigation equipment in more than 40 countries and has done business in Ukraine, but it demonstrates the need to be global and diversified to have a successful agricultural business”.

### AFRICAN OPPORTUNITY

At the other end of the risk spectrum is SilverStreet Capital’s Gary Vaughan-Smith. His firm is dedicated to Africa. SilverStreet’s \$320 million African agricultural fund will aim to make money by assisting small scale farmers to become more productive, he says. SilverStreet will provide farmers with advice and training on how to boost productivity. For example, African famers traditionally burn maize after the harvest, rather than pushing the stalks onto the ground and leaving them to become compost, he says.

“The core of what we are doing in each country is looking at what is the crop or the opportunity in that country and then building a value chain around it,” says Zimbabwe-born

Vaughan-Smith. He grew up surrounded by farmers in Africa before starting a career in asset management. “Our goal is to invest to help develop the agricultural sector and to have a social impact in the process.”

In Tanzania, SilverStreet invested \$22 million this year to start the country’s first soya bean processing plant and feed mill. Tanzania has good conditions for soya beans but production is very low because small scale farmers don’t have anyone to sell the crop to, Vaughan-Smith says. In addition to buying and processing the beans, SilverStreet will also hatch chicks and sell them to farmers.

The Tanzanian investment is designed to have two positive impacts. First, it will provide a market for farmers to sell surplus soya beans. Second, it will provide farmers with high quality chick feed and healthier chicks to rear. Tanzanian consumers will get a domestic source of soya beans and healthier poultry.

“If you can provide a reliable market then you can get huge production in Africa,” Vaughan-Smith said at a conference in London in February. “Tanzania is an amazing opportunity. I hope in five years we look back and it is an incredible case study.”

### COMBINATION APPROACH

TIAA-CREF, one of the world’s largest agriculture investors, takes a varied approach to the asset class investing into both the land and into the processing companies associated with the sector.

“We invest in agriculture through land because land is the key factor of production,” says Jose Minaya, head of natural resources and infrastructure investments at TIAA-CREF. The US pension fund manager owns about \$5 billion of farmland. “We often lease back the land to local farmers, who have local expertise. This also helps us avoid operating risk in our returns.”

In addition to farmland, the pension fund is increasingly looking at the type of investments that Paine & Partners makes. “Everything that grows on our farms has to be processed, packaged and transported,” Minaya says in an interview. “Hence, we will look at more core private equity investments in those areas as well.” ■

*Additional reporting by Louisa Burwood-Taylor*

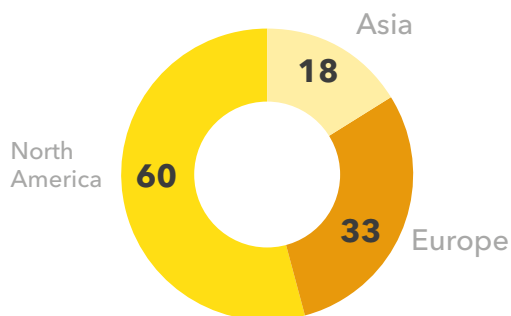


## Global institutional interest

US institutional investors prove the most active in farmland and timberland investing compared with Europe and Asia from the beginning of 2013 to March 14, 2014.

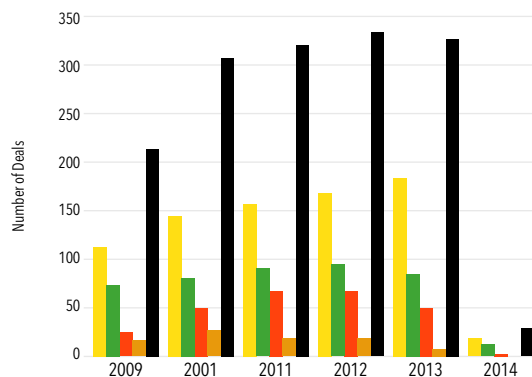
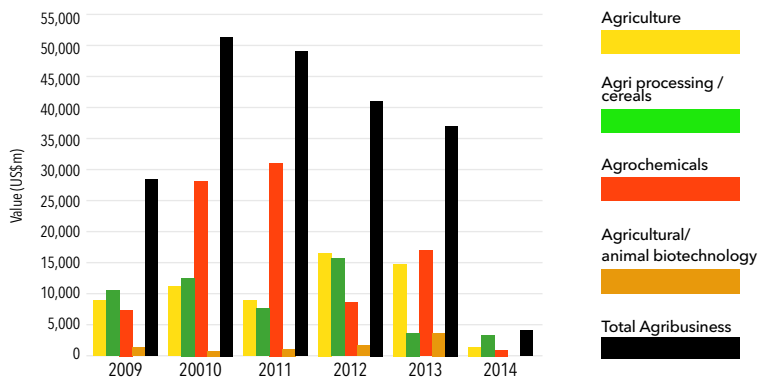
Source: MandateWire

Notes: MandateWire interviewed 3125 institutional investors during the period. The investment activities included are awarded mandates, launched manager or consultant search, ALM study or review, allocated assets, divested assets, terminated mandates, planned to allocate for the first time, planned to make further allocations, administration, custody or advisory.



## M&A trends

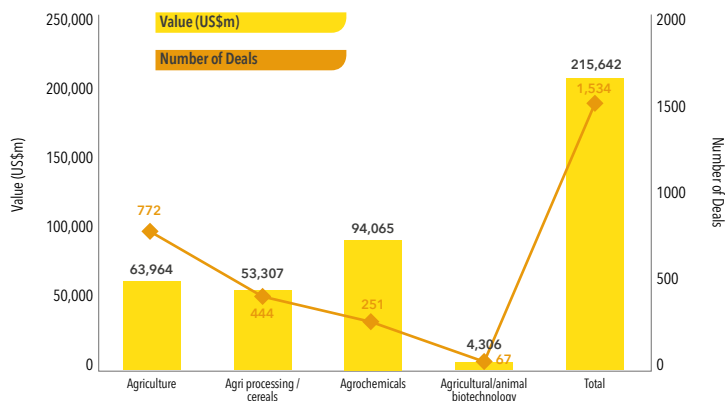
Agribusiness M&A deals have grown in number but declined in value since 2010



Source: Mergermarket.

## Sector plays

Agrochemical M&A deals proved the most fruitful from January 2009 to March 13, 2014.



Source: Mergermarket.

## Global consumption boom

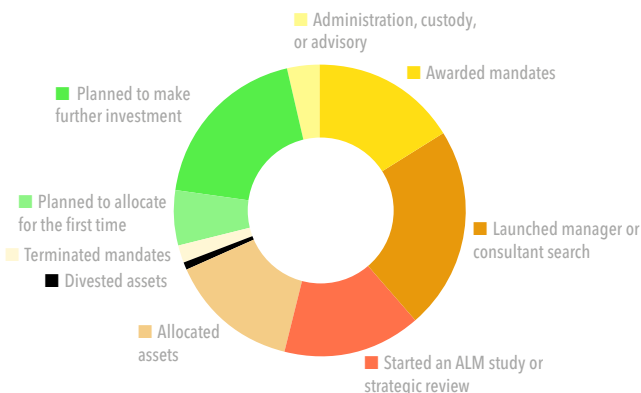
Global demand for cereals, meat and oil crops is on the rise as FAO predicts a rise in calorie consumption per person and nearly 10bn people by 2080.

Indicator	2005/07	2050	2080
Population (million)	6,584	9,306	9,969
Calorie consumption (Kcal/person/day)	2,772	3,070	3,200
Cereals, food consumption (kg/capita)	158	160	161
Cereals, all uses consumption (kg/capita)	314	330	339
Meat, food consumption (kg/capita)	38.7	49.4	55.4
Oilcrops (oil equiv.), food consumption (kg/capita)	12.1	16.2	16.9
Oilcrops (oil equiv.), all uses consumption (kg/capita)	21.9	30.5	33.8
Cereals, production (million tonnes)	2,068	3,009	3,182
Meat, production (million tonnes)	258	455	524
Cereal yields (tonnes/ha; rice paddy)	3.32	4.3	4.83
Arable land area (million ha)	1,592	1,661	1,630

Source: FAO (2012) (Population data - UN 2010 revision).

## Institutional activity

Agriculture asset manager searches were the most popular activity among global institutional investors active in farmland and timberland from January 2013 to March 14, 2014.



Source: MandateWire.

## Private equity league

TPG announced the biggest global agri-related private equity deal between January 2013 and March 17, 2014.

Announcement Date	Deal value (\$m)	Target company	Aquiror
09-Mar-13	871	Inghams Enterprises	TPG Capital LP
09-Dec-13	600	Natural Selection Foods LLC	Kainos Capital for Canadian Pension Plan Investment Board
07-May-13	409	China Modern Dairy Holdings (26.931%)	CDH Investments & KKR & Co LP
12-Feb-14	250	Shanghai Bright Holstan Co (45%)	RRJ Capital
03-Jan-13	187	Bangkok Ranch (80%)	Navis Capital Partners, Rabo Private Equity
25-Feb-13	123	Beijing Sunlon Livestock Development Co (40%)	Affinity Equity Partners
03-Apr-13	100	Bush Foods Overseas (51%)	Qatar Investment Authority
30-May-13	5	Tanzanian Food Corp (Stake%)	Agri-Vie
06-May-13	5	Camson Bio Technologies (18.7925%)	CLSA Capital Partners (HK) Ltd
21-Mar-13	2	Amice Soquet	BPI France

Source: Dealogic

# Cream of the crop

*Timber and farmland investments are better able to withstand downturns and are stronger performers than traditional real estate, but many institutional investors are still on the sidelines. **Evelyn Lee** investigates why.*



**W**hether part of a real estate allocation or the larger category of real assets, timber and agriculture have caught the eye of many public institutions. However, while a number of investors are taking a closer look, few have taken the plunge thus far. Indeed, industry insiders estimate that less than 25 percent of US public pension plans currently have 5 percent or more of their assets invested in timber and agriculture.

The case for investing in both timber and agriculture has grown more compelling, given current economic conditions. “We see demand growing as it relates to the global population growing and a growing middle class,” says Jose Minaya, head of natural resources and infrastructure investments at TIAA-CREF, which manages a forestry portfolio of more than \$1.3 billion and owns more than 400 farms in the US, Australia, Brazil and Eastern Europe. “Yet, on the supply side, you’ve got finite resources, whether it’s agriculture or timber.”

Meanwhile, with interest rates at historic lows, many public institutions have been restructuring portfolios that have been heavily weighted to fixed-income investments – which

are more sensitive to interest rate hikes – to stable assets that could better withstand a rising interest rate environment. Such assets include timber and agriculture, which tend to produce strong income that in turn protects valuations in a downturn.

Timber and farmland also have a lack of correlation to other asset classes. “While stock and fixed-income markets may fluctuate, timberland and farmland investments perform based on the value of the land and crops, as well as the constant underlying demand for food and wood products,” wrote Heather Davis, senior managing director of global private markets and Minaya’s colleague, in a recent paper on real assets. “People have to eat and they need the products that timber creates.”

The two asset classes – sometimes classified as subcategories within an investor’s real estate allocation – are similar to core real estate in that they are hard assets and derive the majority of their investment return from income, although each has distinct drivers. While real estate tends to be driven by employment levels, timber is more influenced by global GDP growth and farmland by population growth. Indeed,



according to data from the National Council of Real Estate Investment Fiduciaries (NCREIF), the correlation between the NCREIF Property Index and farmland is 0.19 percent and -0.036 percent between property and timber.

Notably, forest and farmland investments generally have outperformed real estate. The NCREIF Farmland Index has returned 12.1 percent annually over the past 20 years and 11.6 percent since inception in the fourth quarter of 1990. The NCREIF Timberland Index has returned 8.88 percent annually over the past 20 years and 12.7 percent since inception in the fourth quarter of 1986. By comparison, NCREIF Property Index returns have averaged 8.95 percent over the past two decades and 9.10 percent since inception in the fourth quarter of 1977.

### SUPPLY CONSTRAINTS

Despite these benefits, many investors have yet to make a move into timber and agriculture. “Most investors who are thinking about timber and agriculture are often at the stage of ‘why,’” says Howard Kaplan, president of Farmvest, a Clayton, California-based firm that advises institutional investors on both asset classes. “There’s really a lot more people that are looking and kicking the tires than there are actual investors.”

This isn’t for lack of interest. In the case of farmland, for example, more than \$2 billion in investor capital currently is on the sidelines waiting to be invested, according to a September report from San Francisco-based consulting firm Callan Associates.

The opportunities “are pretty thin,” says Vince Smith, chief investment officer at the New Mexico State Investment Council (SIC), which manages the state’s \$16.5 billion oil and gas endowment. “There’s so many of us with so much money seemingly chasing just a few assets.”

For starters, access to opportunities in both timber and agriculture is limited. The universe of investment managers in these two asset classes is small – Kaplan estimates about 25 managers in timber and roughly 40 in agriculture. Compounding that is the fact that even fewer firms have long track records.



**Smith:** opportunities are ‘thin’



**Franzen:** growing AP2’s allocation

Timber and farmland also are less mature asset classes than property. According to Minaya, agriculture as an institutional asset class is at the stage of development where real estate was 40 to 50 years ago, while timber is about 15 to 20 years ahead of farmland.

### OTHER OBSTACLES

The general lack of familiarity among pension plan boards and committees with timber and agriculture as asset classes has been another impediment. “Whenever you want to do something new, you need to educate your board on the subject before you ask them to take action,” observes Mark Canavan, senior portfolio manager of real assets at the New Mexico Educational Retirement Board (ERB).

Canavan recalls how his first recommendation for an agriculture investment in 2009 was shot down during an investment committee meeting. “I fault myself for not holding educational sessions providing a foundation in the asset classes,” he says. “We have a bright board, but

that doesn’t absolve investment staff from the responsibility to make sure their boards and committees are properly informed.”

ERB’s investment staff later worked to get the committee up-to-speed on farmland, the risks involved with investing and ways to mitigate risks, and the pension plan’s first farmland investment finally was approved in 2010. To date, ERB has committed \$100 million to agriculture in the US and potentially may invest an additional \$25 million to \$50 million this year. It also has allocated \$125 million to timber investments in the US and Brazil, including a \$45 million commitment to Timber Investment Resources in April.

Another obstacle to making more investments in timber and agriculture has been the difficulty of finding investment professionals to focus on the asset classes. Shortly after establishing its new asset allocation policy, New Mexico SIC began an unsuccessful search for a real assets investment officer. While a lack of funds for adequate compensation was an issue, so too was the dearth of people with the desired experience and background. The endowment instead hired a less experienced professional for an analyst position and,



having resolved the compensation issue, now plans to resume its search for a more senior investment officer.

New Mexico SIC has targeted timberland to comprise 30 percent of its real assets portfolio, with the remainder divided roughly equally between energy and infrastructure. The endowment made its first investment in timber last October, committing \$100 million to Brookfield Asset Management’s \$750 million Brookfield Timberland Fund V and plans to make a new timber commitment with the Hancock Timber Resource Group this year.

New Mexico SIC also is considering opportunities in agriculture, although prices for farmland in the US have appreciated considerably in tandem with commodity prices. “We’re just not seeing the opportunities here in the US to get us very excited, but we do see things overseas that could,” says Smith. The endowment does not have a specific allocation for farmland, but it likely would use an equal portion of capital from its timber and infrastructure allocations to fund any potential investments.

#### **NOT FOR EVERY INVESTOR**

Partly because of the challenges in sourcing opportunities, timber and agriculture aren’t appropriate for the short-term investor. “It’s very difficult to buy high-quality assets because people who have them don’t want to sell,” says Kaplan. “It takes patience to assemble a quality portfolio.” Indeed, most funds in the two asset classes typically have three- to five-year investment periods and seven- to 13-year holds, if not longer.

“Farmland is a long-term, illiquid asset class,” wrote Jamie Shen, practice leader of alternative investments consulting at

Callan, in a September report. “It probably is not the right asset class for investors who are looking to judge returns over the next one to three years; it will take that long just to build a portfolio.”

The Second Swedish National Pension Fund, known simply as AP2, began considering timber and agriculture investments as part of a diversification drive that was initiated in 2008. Part of the appeal of those asset classes, as the pension plan highlighted at the time, was the long-term holds of such investments.

“We are looking for investments that are much more long-term and cash-flow oriented than other investment vehicles out there that are a bit more private equity-like,” says Tomas Franzén, chief investment strategist at AP2, which began investing in timber and agriculture two-and-a-half years ago and today has amassed a portfolio of approximately \$400 million.

Last year, for example, the Swedish pension – along with British Columbia Investment Management and the Caisse de dépôt et placement du Québec – were among the institutions that invested with TIAA-CREF in TIAA-CREF Global Agriculture, an entity that raised \$2 billion in capital commitments to invest in farmland in the US, Australia and Brazil. That entity has a 20- to 30-year investment horizon.

Timber and farmland are included within AP2’s 10 percent real estate allocation, a limit that Franzén says the pension plan is rapidly approaching. As a result, the pension may consider increasing its overall real estate allocation in the fall, potentially by an additional five percent.

Franzén anticipates that AP2’s current 1.5 percent

allocation to forest and agriculture will grow in the future and be funded partly through the sale of public equities. That said, he expects “there will be scarcer opportunities overall in alternative real estate markets like timber and agriculture than traditional real estate.” One critical issue with putting capital to the former asset classes is the social, environmental and governance impacts of such investments. “That hasn’t necessarily restricted opportunities greatly, but I would assume that it will reduce opportunities somewhat,” he says.

### RISKS AND MITIGATION

Private market investments in timber and agriculture are subject to a multitude of risks, such as property value fluctuations and volatility in commodity prices. Additionally, the markets lack transparency, particularly with farmland, where the vast majority of properties still are held by private owners rather than institutional investors.

Timber and agriculture investments also can involve putting capital into emerging markets such as Brazil, which has a climate that is conducive to both forests and farmland. The downside of emerging markets, however, is the lack of adequate infrastructure to support the transport of goods to market, as well as the higher political and financial risks.

Kaplan points out that, while more developed markets like the US have a more established infrastructure to support timber and agriculture, that too comes at a cost. “You pay up for it because it’s mature,” he says. “If you invest in Brazil, where the infrastructure still is being developed, you’re in much more of a growth situation than a mature situation.”

Investors, however, have ways of mitigating the risks relating to both timber and agriculture. The advantage to timber is that the owner can simply choose not to harvest, which makes the trees become more valuable every year. “You can store value in timberland, even though the price is subject to cyclicity,” says Smith. And while farmland prices rise and fall with commodity prices, underlying agriculture demand continues to grow.

Moreover, in the case of farmland, investment managers typically buy the land and then lease the properties out to farmers. Investors therefore earn stable income from the farmers’ rent payments and also are protected from the risks of operating the farms, including external factors such as weather and drought.

Diversification also is critical, both by geography and strategy. Canavan plans to consider more investments outside of the US, such as Australia and New Zealand. “With regards to the theme of global population growth, you want to be able to have your product closer to that population,” he says. He also plans to pursue more opportunities where New Mexico ERB will own and operate its own agriculture properties.

“I want to be involved in not just commodities, but have exposure to more of the value chain,” Canavan says. While he acknowledges that such a strategy would likely require a “boatload of money” and may be viewed by some as taking on a greater amount of operational risk, he considers a more extensive involvement in the agriculture process as having a lower-risk profile because of the ability to exercise greater pricing power by bypassing large commodity buyers and selling directly to end users.

### GROWING OPPORTUNITIES

While the finite nature of natural resources like timber and agriculture remains a major challenge, it creates an opportunity for investors with long-term, sustainable objectives. “The supply curve is inelastic,” says Minaya. “As you try to respond to demand, it will take a considerable amount of time to shift the supply curve.” While improvements from an infrastructure and productivity standpoint will help to increase future supply, it won’t happen overnight, he adds.

Rising investor interest also is expected to help expand available investment opportunities. “As demand for investments picks up, the supply available to investors also picks up,” says Smith. “As more managers come into the space and act as a conduit, investors like us will be able to own more land.”

Smith notes that railroad companies and other large landowners historically held much of the timberland in the US on their balance sheets, but more properties became available for sale as institutional interest in these assets grew. “I think that same process will take place in the farmland space,” he says.

Smith is glad to see more of his peers moving into timber and farmland for the first time. “Public institutions really are doing themselves a favor by diversifying their portfolios in these areas,” he says. “Over and over again, I’ve seen people moving too slowly and moving too late into things that seem pretty clear we should be doing.” ■





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