NEWS LETTER 2018

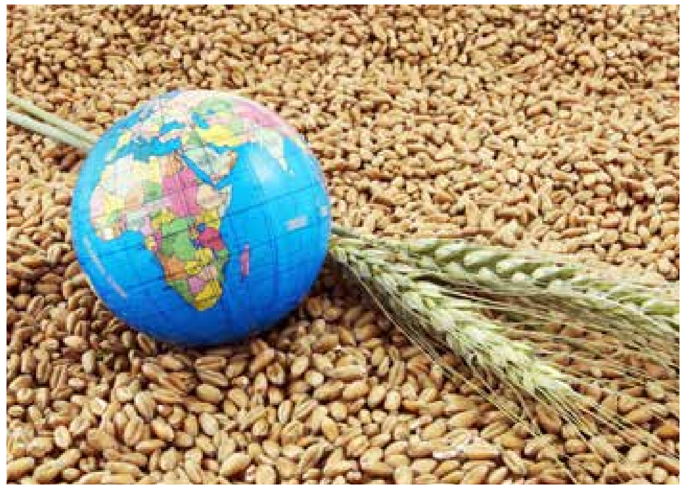
INTERNATIONAL AGRICULTURAL INVESTMENT

InvestAg

INTRODUCTION

Over the last decade, agricultural investment has become a mainstream asset class for both institutional and private investors.

In this newsletter, we look at how the food and agriculture asset class in general has evolved and become more sophisticated over the past ten years, from almost a standing start. We also examine investor types and their investment strategies, and touch upon the main farmland markets around the world. There are currently several significant factors at play that might impact on short-term global agricultural investor confidence such as commodity prices, Trump's trade wars, BREXIT, and droughts or lack of rain in parts of Australia and Europe. Farmers also increasingly must take account of sustainability issues affecting the use of pesticides and fertilizers on their land.



GLOBAL AGRI-ECONOMICS AND POLITICS

Agricultural commodity prices have begun to strengthen again, after two years of stability. Up until 2016 we had seen continual decline in prices from 2011, which impacted on global farming returns and farmland prices. This recent strengthening is in part due to reduced areas of soya beans and maize planting in the US and a poor South American soya bean harvest. We have also seen the dry summer in many wheat producing countries across Europe and the CIS, reducing reserves of the major exporters to the lowest level since 2007/8. This in addition to the reduced prospects both in Australia and also for US spring wheat yields, have pushed prices of wheat to their highest for three years. With worries over global stocks, are we in for another price spike in food prices worldwide, as we saw in 2007? If so, this could have a positive effect on international land prices.

In addition to weather, politics can also play a part in the fortunes of agriculture. China's tariffs on US soya beans, in return for Trump's tariffs on Chinese imports, are hurting US farmers. However, other countries may step into fill the gap; if so this will change the acreages covered by other crops they grow. In Europe, the continuing uncertainty of BREXIT makes it more difficult for agri-traders and producers to plan ahead. The biggest impact thus far has been on British farmers, who will also have a new and as yet unknown farm subsidy regime to contend with. These unknowns have already affected UK land values.

Other factors to consider when making agricultural investments are exchange rates. The performance of cross-border investments can be transformed by the timing of entry and exit. For example, with Sterling at such low levels against the Dollar and Euro, UK farmland is looking good value historically for international investors. Annual farm returns are also impacted by the strength or otherwise of the US dollar, the global commodity currency, as it affects local crop and energy prices. In the UK, the current EU subsidy payments are impacted by the exchange rate between Sterling and the Euro.

AGRICULTURAL ASSET CLASS CONTINUES TO GROW

The growth in the agricultural asset class has been driven by a number of factors, including the desire to find alternative forms of investment, long-term security in the face of volatility in economies and markets, the widely publicized ever-increasing demand for agricultural commodities/food with a growing population and the long-term trend of rising land prices - over centuries land assets have consistently grown in value.

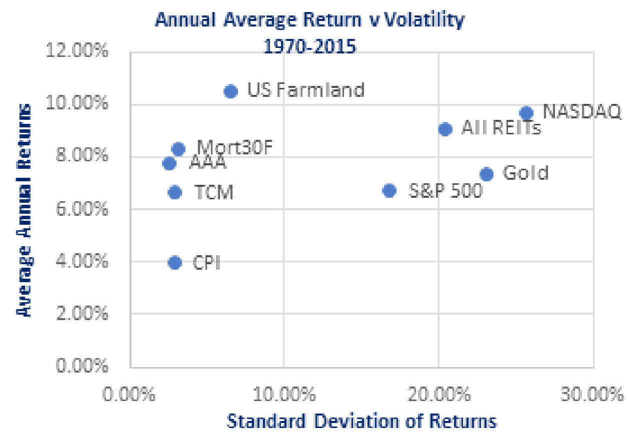
Agricultural investment has consisted of both liquid and illiquid strategies. There has been an increase from 38 investment funds in 2005 investing in food and agriculture, to 446 in 2017 with total assets under management of US$73 bn (source Valoral Advisors). Farmland comprises over 40% of such funds by value. Whilst these numbers demonstrate the increasing trends, it excludes the many private direct investments made by institutions and private investors.

With the continuing acceptance of the sector as institutional asset class, there has been an ongoing a shift over the last decade to uncorrelated illiquid private strategies such as farmland and private equity, away from publicly traded investments such as listed equities and commodities. This is due to listed agribusiness equities' performance being linked to the rise and fall of the stock market and exchange traded commodities underperformance in recent years.

More than half of institutional type agricultural investment has been in North America. South America is the next biggest investment destination, followed by Europe and then Australia/New Zealand. Farmland is the dominant investment strategy for investors targeting North America, South America, Australia and New Zealand. However, in Europe investment is predominantly in private equity, with more limited exposure to farmland.

Agriculture in comparison to many other industries has suffered from a lack of R & D, but we are now seeing the level of investment growing at a fast rate, with exciting new technologies being developed and adopted in food and agricultural production, supported by dedicated venture agribusiness capital funds. These include urban farming, irrigation software technology and crop monitoring software using drones and satellite amongst many other things, all contributing to 'smart agriculture', and using resources more wisely, while increasing yields.

THE ATTRACTIONS OF FARMLAND INVESTMENTS



Source: Prof Sherrick, TIAA Centre for Farmland Research & University of Illinois

Farmland is considered a safe, long term, uncorrelated and in some markets a tax efficient investment. All attractive characteristics for investors looking for preservation of capital and portfolio diversification. Even during the World Financial Crisis in 2008 and 2009, when most other asset classes were hit, farmland continued to deliver good returns, showing its lack of correlation with other mainstream asset classes.

Institutions started to invest seriously in farmland in the 2000s, however it is still predominantly owned by private farming families around the world, with the level of institutional investment thought to be less than 1% of the total.

Over the last ten years we have seen a shift from the core institutional farmland investment strategy of just buying US arable (row crop) farmland and leasing it to operators, towards exposure to other international farmland markets such as South America and Australia, as well operational risk-taking particularly in higher value permanent cropping with the attraction of an increasing demand in perceived healthier foods such as nuts, olive oil and blueberries.

Farmland v Timber

At first glance, farmland and timber have similar investment characteristics, namely their capacity to provide portfolio diversification, current returns and a hedge against inflation. Both assets are driven by biological returns, but farmland's return is also driven by land appreciation. However, timber romped ahead as an institutional asset class because of its higher shorter-term returns and lower price volatility - you do not have to harvest timber if prices are weak. During the World Financial Crisis, timber returns suffered due to the lack of demand for its products, unlike farmland which continued to show strong returns as people still needed to keep eating. This changed the perception of mainstream investors, and many investors in timber have now invested in farmland and are looking to increase their allocation further, with a number of others looking to invest. Although farmland is perhaps 20 years behind timber as an institutional asset class, it is catching up fast. The current level of institutional investment in food and agriculture funds is US$ 75bn (US$32bn in farmland) compared with timber's US$150bn (source: Valoral Advisors). However, the investable universe for farmland is over three times the size of timber (US$1,000 bn v US$300 bn).

INTERNATIONAL FARMLAND MARKETS

After the initial wave of institutional-type investment in the 2000s, we saw an increase in commodity prices, causing farmland values to increase dramatically in many of the international farmland markets around the world. Farmland values and returns were not impacted by the World Financial Crisis, but a fall in commodity prices from 2011 onwards put a downward pressure on farmland annual returns, resulting in a softening of some land markets.

North America

The US still is the destination of choice for many investors, due to its relatively high consistent annual returns as a landlord, in comparison to the other obvious mature farmland markets in Western Europe. After a significant rise in land values over the previous ten years, since 2014 farmland prices in the US have mainly plateaued. Some regions however such as the Mid-West Corn-Belt have seen a fall in values from their peak as a result of strong global production over the last four years and rising stocks. This led to declining commodity prices and a drop in farm incomes, depressing total farm returns. Total US farm returns in 2017 for cropland were 4.75%, 4 bps up from 2016, due to slight increases in capital appreciation and operating income (Source: NCREIF). Permanent cropland total farm returns in 2017 are considerably higher as usual at 8.1%, albeit down 119 bps from 2016 (Source: NCREIF). Whilst there has been much noise and concern about Trump's trade wars and the resultant trade tariffs being imposed by China on US soya bean imports, average farmland values across USA still increased by 1.9% in Q1 and Q2 2018, showing investors are concentrating on the long-term investment characteristics of farmland. Having said that states that are major growers of wheat such as Kansas, Minnesota and the Dakota's have seen modest price reductions.

South America

South America has seen similar trends in land prices to the US. Brazil initially attracted the most institutional investment, however the political and economic environment and foreign ownership restrictions of farmland in recent years has been challenging for investors, despite offering excellent agronomical conditions for broadacre farming. Argentina likewise has similar attractive agronomic conditions, but politically has been difficult with foreign ownership restrictions, but the new government, with its pro-business agenda has allowed the farmland markets to open up again. Chile and Uruguay are the current favoured nations in LatAm for institutional investment, as they are considered safe countries in which to invest. Institutions have invested in permanent cropping and dairy farms in Chile, and in Uruguay has seen a preference for arable and dairy farming investments.

Australia /NZ

After North and South America, Australia and New Zealand saw the next wave of institutional type investment. New Zealand led the way with dairy farm investments, until the global milk price fall in 2014/15, making it a less attractive investment destination with land prices falling. Australia is amongst the world's lowest cost and most competitive agricultural producers, with the highest non-subsidy return for most mainstream agricultural commodities. Cash returns are usually in line with or even better than US equivalents. However, both market and weather volatility, in Australia, as seen in this year's drought in New South Wales and Victoria, has to be factored into any investment consideration. In 2017 across Australia, there was an average price increase of farmland of 7.1%, driven by agri-investment interest. There were however mixed results across the country, with southern Australia (Tasmania, NSW, South Australia and Victoria) all showing gains and Queensland, Western Australia and the Northern Territory seeing price falls. Over the last 20 years the average farmland performance for the whole of Australia has shown an average increase of 6.6% year-on-year. With so many farming businesses in distress in NSW and Victoria, no doubt there will be good value buying opportunities for some. (source: Rural Bank – Farmland Values 2017)

Source: Rural Bank – Farmland Values 2017

Central Europe

The Baltics, as well as Poland, Romania and Bulgaria are interesting investment targets for investors looking for capital value increases across the region. It has seen the highest increase globally in capital values over the last decade. This is due to the ongoing convergence of prices with those in Western Europe as a result of EU membership, and combined with the adoption of CAP subsidies, EU investment grants, land consolidation and new sophisticated agricultural practices.

Western Europe

Regions which seem to have attracted new institutional type investment in farmland are Denmark and Spain/Portugal. Denmark's land values came off considerably in the credit crunch in 2008 due to over-borrowing in the sector but are expected to re-converge with those of neighbouring Germany. Permanent cropping in Iberia has attracted investment due to the increase of consumption of olive oil and almonds for health reasons, plus the opening up of new irrigated areas in the Alqueva region of Portugal.

The uncertainty of BREXIT is presenting interesting value opportunities in the UK, with considerable softening of the land market in some regions, making attractive value buying opportunities for the long-term investor, be they institutions or family offices. This is particularly so for overseas investors, due to the weak Pound.

CIS

There have been few cross-border success stories in Russia, however there are large Ukrainian farming conglomerates which continue to prosper. Ukraine agronomically still has considerable potential possessing some of the best soils in the world, but it is not for the faint-hearted investor.

Sub-Saharan Africa

Africa has mainly been the domain of either private investors, DFIs or charitable foundations. The mainstream financial institutions have largely given the region a miss due to many challenges, despite improvements in the business and economic environments in some countries. The countries that have attracted most private investor interest for broadacre farming include Zambia, Tanzania and Mozambique.

AGRICULTURAL INVESTOR REQUIREMENTS

Many investors who appreciate the strong macro arguments for investing in agriculture, do not always find it easy to invest. As the asset class is relatively immature, investors have sometimes struggled because of the lack in-house expertise, making them perceive that the risks are greater than they actually are.

Institutions

Institutional type investors range from pension funds, life insurance companies, endowments, charities, sovereign wealth funds in the Middle East and Far East, DFIs, the big trading houses such as Cargill and ADM, as well as the huge Asian conglomerates. Understandably the financial institutions such as Pension Funds have invested in a very different way to the Sovereign Wealth Funds who are food security driven. The Pension Funds on the other hand are looking to increased overall returns of their entire investment portfolios and to manage risks by diversification.

The financial institutions from North America and Europe are the main institutional players in the sector. The core initial investment strategies have been to buy arable (row crop) farmland in North America let to farm operators, due to its simplicity and strong returns without taking operational farming risks. A number of the very large institutions have invested directly through their own in-house teams. Others have either invested via third party asset managers on a managed account basis, or joined forces with other like-minded investors in pooled funds. Recently we have seen more institutional co-investments and also wider investment strategies up and down the agricultural value chain, in order to fulfil their allocation to agriculture and secure higher overall returns.

Family Offices

Family offices, many of which have always had exposure to real assets of some sort, are also increasing their exposure to international agriculture. This is usually for multi-generational preservation of capital purposes, as well as to secure annual cash returns, particularly in this current environment of low interest rates. Clearly family offices come in all shapes and sizes, with a wide variety of decision making processes, with some driven by more altruistic reasons such as social and environmental investments. UK farmland has a particular attraction for British family offices, as it benefits from considerable tax benefits, including the ability to gift it to the next generation free of inheritance tax.

Asset Managers

Investors understandably prefer to invest with seasoned asset managers with long track records and strong governance. The number of investment funds and assets managers is still pretty small compared to other asset classes, including timber, and there are only a few asset managers who would pass this test. This limits investors options and is also frustrating for the first-time asset managers, particularly in more exotic markets, who often find it difficult to raise capital however long their actual agricultural management pedigree is.

The US leads the way with the most sophisticated agricultural asset management industry. The bulk of the initial institutional agricultural investment was and continues to be in the form of large-scale managed accounts, with some major institutions managing their portfolios in house. Many investors are shying away from blind pool managed funds and preferring either direct investing or co-investing in order to take control and reduce costs in order to maximise returns. A number of managers are now offering co-investments on a deal-by-deal basis to get a better fit structurally for their investor base.

As the agricultural asset class has matured, we have seen a larger number of funds and structures being offered by asset managers, with a widening of type of investment strategies up and down the agricultural value chain from inputs, farmland and farming, to processing and private debt, which is more liquid. This is giving greater access across the sector to smaller institutions, family offices and hedge funds, widening the investor base.

CONCLUSION

We expect to see an ongoing evolution of agriculture as an asset class as it matures, with more asset managers offering a wider range of more sophisticated and novel investment structures and strategies. We have seen this in other real asset investment classes such as Real Estate and Timber, which has led to greater investment by a wider range of investors. With continuing growth in the World population, and more diversified and middle-class consumers in emerging markets, plus sustainability issues, ongoing agricultural innovation and investment will always be needed, which makes an optimistic future for long-term investment in farmland and agriculture in general.

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A dedicated investment advisory and asset management business for international agricultural investors, with an ability to access and manage significant agricultural investment opportunities in the main farmland markets around the world.

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