

Down on the farm: investing in agricultural land

Friday 5th March 2010

Investors are ploughing billions into farmland acquisitions convinced that food prices and land values are being driven upwards. Is farming as lucrative an investment as some commentators suggest?

If investment cognoscenti are to be believed, farmland will be the most stable and sensible purchase anyone makes over the next 10 to 15 years. Described by one analyst as "oil with yield", and by another as the "best strategic asset" for the 21st century, farmland is increasingly being viewed as a "must have" tactical component in a well-diversified investment portfolio.

While global stock markets remain mired in uncertainty more investors are seeking alternative assets for diversification purposes and as a hedge against inflation – an ever present danger. Arable and beef farms have a high positive correlation to inflation like precious metals but generate a stable income stream from operating yield. In general terms, returns have also been greater than traditional investments such as stocks and bonds over the past 20 years, with less risk.

Australia has the cheapest land values of all developed markets. A report from the Australian Agribusiness Group found that the top 25% of farms made an average annual return of 11% over the past 12 years, which is significantly better than bonds and equities.

Australian national Philip Jarvis of Philip Jarvis Associates, an estate manager and investment advisor to family offices and high net worth investors, reckons land values – which are calculated according to how much stock the land can support – will increase as more investors flock to the country. "We look for run down farms where production – and therefore land values – can be doubled with the right management," he says. "It's hard work but the investment returns can be eye watering."

Jarvis has been working with a UK family office to develop a portfolio of farms located in the New England area of New South Wales. Several years ago the portfolio was worth around £6 million, but with a little extra borrowing, some clever leasing arrangements and a few astute acquisitions the portfolio is now worth some £25 million. It would appear that with investment flair and a safe pair of hands there is very little you cannot do with farmland in Australia. But as Jarvis points out, the opportunities won't be there for much longer.

Spotting the investment potential of farmland is the easy part, but finding the right farm at the right price requires on-the-ground knowledge and operating experience. These are qualities that today's private equity firms are sorely lacking and many have run into difficulties as a result.

Pharos Financial Advisors, a specialist emerging markets advisor with offices in Moscow and Dubai, recently teamed up with Miro Asset Management Limited, a Dubai-based global agriculture and timber manager, to launch a \$350 million fund focused on acquiring and developing land in Eastern Europe, Eurasia and Africa

Pharos is not alone in its land ambitions but chief executive Peter Halloran thinks the fund has a unique selling point. "By combining our emerging markets background with Miros' operating

expertise in agriculture, we believe we have created a significant edge for ourselves in identifying and running commercial arable farms," he says.

The timing of the fund launch was fortuitous. "Land markets globally have come off their peak values as a result of the global financial crisis and uncertainty about the emerging markets growth story," says Halloran. "We have no doubt that as soon as market confidence returns prices will recover momentum. Agriculture is not the dull sector it was 30 years ago. We see it following a similar trajectory as the oil industry a decade ago."

Pharos has already identified a high quality pipeline of arable farm projects that meet targeted returns of 25% annualised, including significant operating yield. Given the paltry returns anticipated on traditional investments, Halloran is having no problem convincing potential investors of the merits of the fund. "Family offices and pension funds have a huge appetite for this type of investment but they are also astute enough to recognise the fallibility of some investment projects," he says. "There are scores of short-term speculative investors out there who have no intention to farm the land."

Pharos will focus initially on rice farming in Africa and cereal cultivation in Eastern Europe. The fund has a minimum subscription of \$5 million and is designed to have a five to seven year life span. The fund aims to be cash generative within one or two years. At the end of the investment period the fund will be unwound and the assets liquidated via buyouts.

Eastern Europe is growing in popularity with corporate and private investors because land valuations are low in comparison with many western markets. While Pharos likes to buy farmland outright with a view to capitalising on rising land values as well as operating yield, many investors simply purchase the right to lease the land. In some parts of the world leasing is the only viable option because of government restrictions on foreign land ownership.

Aston-Lloyd, a UK-based investment manager, recently launched a specialised fund for farmland investment in the Ukraine. The land, located in the Crimean Peninsula, is under a 15-year lease. Eurofarms LLC was contracted to run the farms for production of wheat, barley, rapeseed, maize and sunflower. Participating investors get a share of the profits from the harvest. The structured exit is at five years, with a projected capital appreciation of 415%. Some institutional investors are offering to buy up the project on completion, according to a spokesman for Aston-Lloyd.

There are few regions of the world where land hungry sovereign wealth funds and cash-rich private investors have not left their mark. Family offices from the US and Europe have been particularly active in Latin America, where the cultivation of soybean and sugar cane for ethanol production has been stoking the bio-fuels revolution.

Ireland's Abbeyfield Group, a privately owned holding company with interests in banking, energy and real estate, has been active in Paraguay since 2004. Commenting on opportunities in this under-penetrated market, Conor McEnroy, head of Abbeyfield Group said: "If you want to make an investment in a country with strong GDP growth, the best investment you can make is raw land. Paraguay offers one of the best price/value ratios for agricultural land in the region with costs per acre some 50% lower than Brazil."

Pasture land in Paraguay can be bought for between \$80 and \$50 per hectare while prices for prime agricultural land varies between \$2500 and \$3500 per hectare, though McEnroy was quick to point out that investing in Paraguay is not a picnic. "You have to visit the country regularly and take your due diligence

responsibilities very seriously," he said. "The work required is such that many of the global investment management firms are reluctant – or unable – to commit resources to agricultural land opportunities in places like Paraguay."

As well as cultivating sugar cane – an increasingly profitable commodity – Abbeyfield Group has invested in two ethanol distilleries. "If people want to take the Copenhagen agreement seriously ethanol must be treated as a necessary fuel for the future," says McEnroy.

McEnroy's ambitions are constrained only by the amount of capital he has available to invest. With compound annual returns in excess of 30% over the past five years, it is likely that Abbeyfield Group's Paraguay ventures will have potential co-sponsors lining up with their cash offerings.

Another part of the developing world that is attracting investor interest is Sub Saharan Africa, though in comparison to many other emerging markets this is a tough nut to crack. While land values in Africa are amongst the lowest anywhere, the farms that are available for sale tend to be basic and in need of considerable investment. One Swedish private equity firm was forced to wind up its farm operations in Africa because it underestimated the amount of investment needed to make them commercially viable, according to Halloran. Many other investment companies buy land in Africa only to find that they are unable to do anything with it.

Emergent Asset Management Limited counts itself as one of the continent's success stories. The UK-based investment company, in partnership with Grainvest, a firm of agricultural traders and farm operators in South Africa, launched the African Agricultural Land Fund towards the end of 2008. The fund has proved so popular with investors that a new sub fund was launched at the end of 2009 to meet demand. The minimum subscription is €500,000 for private investors and €5 million for institutions. The targeted annual return is in excess of 25%.

Many investment companies aim to make a positive contribution to the wellbeing of the local communities in which they invest, but the transfer of thousands of hectares of land in Africa and Latin America has raised a number of concerns. More than one commentator has judged farming forays into these markets as neo-colonialist. Others have been even less generous. If the emerging markets 'land grab' continues – and it shows no sign of slowing – commentators are bound to become more vociferous in their condemnation of this practice.