

Agricultural Land Investment

Ag Lands - a bright spot in the 2009 investment landscape

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March 2009



Investing in Agricultural Lands

Within the last three to four years there has been a surge in interest in agricultural land investing among institutional and family investors. With the global food crisis having moved off the front pages, at least for the time being, and with falling prices for soft commodities, some of the frenzy witnessed 12 months ago has been tempered. Yet, there remains a strong interest in the sector based on a number of factors:

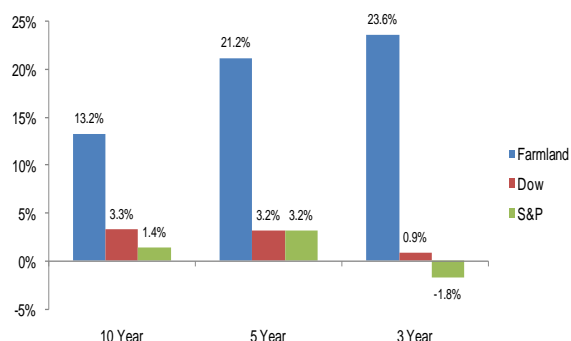
- Strong long-term fundamentals
- Attractive historical returns
- A mix of current income and capital appreciation
- Uncorrelated returns
- A strong inflation hedge

Investors ranging from large institutions, specialist hedge funds, pure-play public companies, and sovereign wealth funds are acquiring lands in North and South America, Australia, Eastern Europe, Sub-Saharan Africa, and S.E. Asia. Strategies run from conservative (e.g., currently productive permanent cropland in the U.S.) to aggressive (e.g., undeveloped row crop land in emerging agricultural regions).

Investment in farmland by private individuals and their families has a long history. In the 17th and 18th centuries, European capital was invested in land grant companies which, often operating under a royal charter, developed virgin soil into productive farmland in newly “discovered” lands in the Americas (to produce salted beef, wheat, barley and sugar, etc.), Africa (grains and tropical oils), and Asia (spices and rubber). Investment in farmland by family investment groups continued through the colonial era well into the mid-20th century, accounting for a significant share of total agricultural production and has continued to the present in certain regions such as South America. In Europe, investment in agricultural land has evolved into an activity for farmers operating relatively small parcels (with certain exceptions such as the wheat basin surrounding Paris). By contrast, In South America family groups are active investors in large integrated landholdings and in the U.S. they tend to be passive investors in land rented out to fulltime farmers or managed under contract by professional management companies. In Africa, Eastern Europe and Asia/Pacific, professional management companies funded by private family investment groups

are establishing land banks to improve the productivity of existing farmland or develop previously unexploited land for crop production.

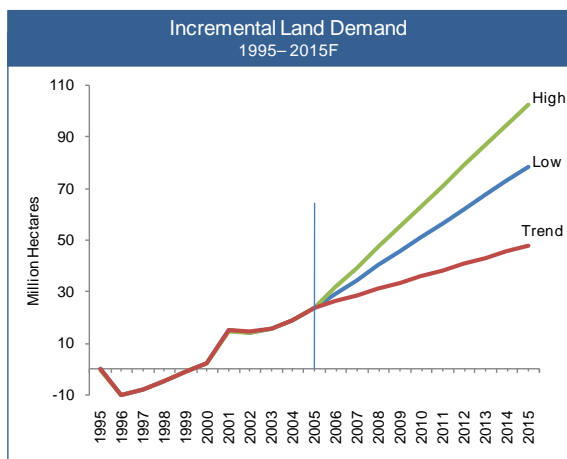
Strong Historic Returns



In the US a majority of institutional landholders are members of the National Council for Real Estate Investment Fiduciaries (NCREIF), which tracks total returns for farmland investments on a quarterly basis. For the 10-year period ending 12/31/08, the NCREIF index showed an average return of 13.2%. Land investments provide current income in the form of either lease payments or from the sale of the crop. In North America, lease payments are typically a fixed dollar amount while in South America, annual payments are typically a fixed share of the production (i.e., the landholder shares the commodity risk / return directly).

Attractive Long Term Fundamentals

Growing world population, rising incomes in the developing world and the increasing use of biomass for biofuels and for industrial applications will drive unprecedented growth in demand for agricultural crops over the next decade and beyond. Even accounting for potential improvements in production yields resulting from improved genetics and agronomic practices, significant additional acreage will need to be brought into production. Based on our demand projections for a basket of 7 key crops (wheat, corn, soy, cotton, rapeseed, sugarcane, palm), a *minimum* of 75 million hectares of land will need to be brought into cultivation by 2015. However, there is only ~1.4 billion hectares of

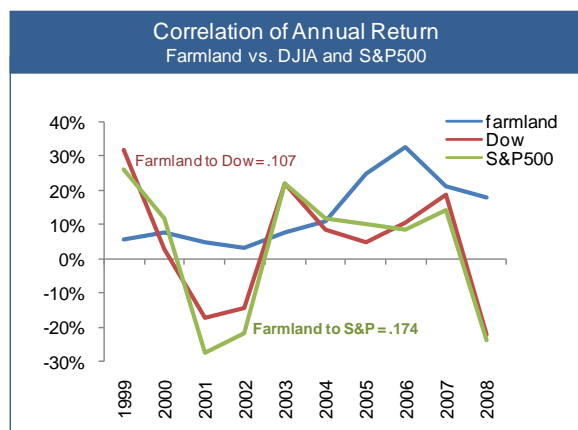


Source: FAPRI, UN FAO, Highquest Partners Analysis

available for production worldwide, and less than 24 million hectares were brought into cultivation during the 10-year period ending in 2005.

The challenge to bringing additional land into food production is compounded by the fact that agriculture competes with alternative land uses (especially in the developed world). Further, the UN estimates that 12-19 million hectares of land are lost annually due to deterioration (expanding deserts and soil depletion). This scarcity of land will drive up prices of agricultural commodities and of farmland for the foreseeable future.

Uncorrelated Returns



Source: NCREIF; HighQuest Analysis

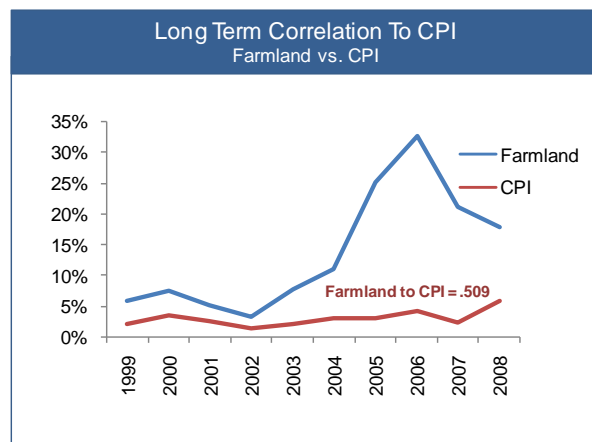
A major attractive feature of farm land investing for long-term investors is the low correlation between returns on farmland investments and the broader markets. Over the past 10 years, the correlation of the

quarterly returns on the NCREIF with the DJIA has been 0.107 and with the S&P 500 it has been 0.174.

One major U.S. institution with a \$300+ million portfolio of U.S. farmland, has reported that current return – lease renewals signed during the current economic crisis at the end of the 4th Quarter of 2008 – are up 30-35% for 2009 over 2008.

Inflation Hedge

Historically, farmland investments have provided an effective inflation hedge, with returns highly correlated to the Consumer Price Index. Over the past 10 years, the correlation between the quarterly returns on the NCREIF and the CPI has been 0.509. Crucially, the return on the NCREIF has been higher than the inflation rate in each of the past 10 years.



Global Opportunities in Farmland Investing

Today, a variety of investment strategies and vehicles are being devised and implemented to develop farmland production in different regions of the world. These approaches are customized to respond to local conditions: type of production, access to financial networks and sources of capital, political/legal/governance issues, infrastructure challenges, environmental sustainability constraints and overall risk/security challenges.

North America is perhaps the most mature market for farmland. While farms in the U.S. have been consolidating for decades, the size of individual parcels remains small compared to South America, Eastern

Europe and parts of Sub-Saharan Africa. In North America, there is little if any undeveloped farm land for conventional crops (though opportunities are developing due to improved genetics and increased focus on non-food crops to produce on land previously considered marginal if unproductive), so returns are derived from current income in the form of lease payments or from the sale of production, and long-term appreciation of the land itself.

In contrast to North America, agriculture in the southern zone of South America is practiced on a massive scale, with operations consisting of tens of thousands of hectares where the operations tend to be integrated (crops grown for the cash markets – domestic and export – as well as used to feed livestock and poultry and produce energy.)

In Eastern Europe (Russia, Ukraine and the former CIS), while farming is conducted on an industrial scale, it continue to suffer from poor yields and lack of adequate infrastructure. In this region, financial investors contracting with professional farm management operators as well as local strategic investors are buying or leasing vast tracts to apply western farming practices and inputs (high yielding seeds and fertilizers) in an effort to dramatically boost yields. In addition, they are investing in infrastructure projects to store, process and transport their production. Investment in both areas should lead to increasing the overall productivity of the land and hence result in appreciation over time of land values in the region.

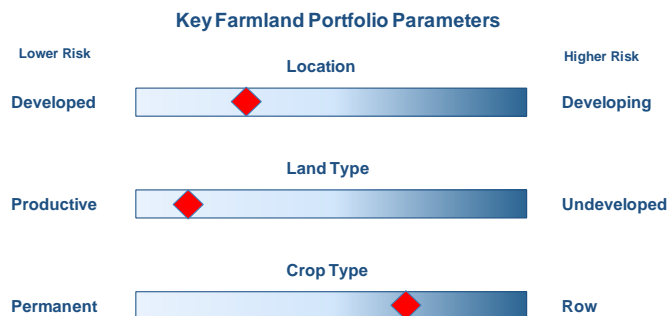
Designing a Farmland Portfolio

Farmland should not be viewed as a homogeneous asset class. Investors can tailor a portfolio to meet their individual risk profiles by balancing their investments across 3 key parameters.

- **Developed vs. Developing Country** Not surprisingly there is more upside potential in the developing world, where per unit land acquisition costs are lower and there is often the potential to rapidly improve crop yields thereby boosting production and increasing the value of the land. However, investment in the developing world poses political and other risks that investors may prefer to avoid. In contrast, developed world farm land is more productive and hence more fully valued today.

Nevertheless, pressing demand for increased agricultural production will continue to drive developed world farmland valuations.

- **Permanent vs. Row Crop** Historically, row crops such as corn, soy, wheat, barley, etc. have provided a more volatile return than permanent crops because their supply can respond to more quickly to market conditions. When corn is more profitable, U.S. farmers shift acreage from soy to corn (within the constraints of crop rotation required to maintain nitrogen levels in the soil). On the other hand, it takes years to bring an apple or almond orchard into full production, and the switching costs are very high. As one would expect, each crop has its own specific economics, and carries its own risks. Coffee, cocoa, almonds, apples and wine grapes each represent distinct markets with distinct opportunities and challenges.



- **Productive vs. Undeveloped Land** For investors who can wait from three to five years to bring land into production (and develop the infrastructure required to store, process and transport that production), investments in undeveloped frontier land can provide the highest potential returns. These investments do not have a current return in the early years, but the potential for capital appreciation is far higher.

While farmland investments have been part of the portfolios of wealthy families for centuries, in the current economic environment this asset class is attracting renewed interest. Growing world populations and rising income levels in the developing world will accelerate the demand for both vegetable protein and animal protein and consequently for the crops which are

used to produce them. The incremental demand for biomass as a feedstock for both biofuels and a range of green-chemicals (from polyethylene to detergents) will place additional pressure on scarce farmland resources to produce the necessary crop volumes. Even with anticipated increases in crop yields from seed genetics and more efficient farming practices, farmland will remain scarce for the next decade and beyond. These long-term fundamentals combined with historically uncorrelated returns generated by farmland investments make this an attractive asset class for the portfolios of many wealthy families.

Mr. Stookey and Mr. de Lapérouse are Managing Directors of HighQuest Partners, a leading strategy consulting and advisory firm to the global food, agribusiness and biofuels sectors with offices in Boston and St. Louis. HighQuest helps clients from seed companies, to processors, traders, marketers, food companies and biofuel producers make strategic operating and resource allocation decisions based on rigorous analysis and proprietary insight. HighQuest also advises investors on opportunities within the agricultural sector from global land acquisition to infrastructure project feasibility to commodity trading strategies.

HighQuest Partners LLC, together with the Investment Management Institute, is hosting the “Global AgInvesting 2009” conference in New York City, June 22-23, 2009. For more information on this unique opportunity to learn more about investing in the Agriculture sector with a focus on farmlands and infrastructure, go to www.globalaginvesting.com.

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