INTERNATIONAL FARMLAND INVESTMENT
PERMANENT CROPS 2019/20

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Investors Acquire an Appetite for Permanent Crops

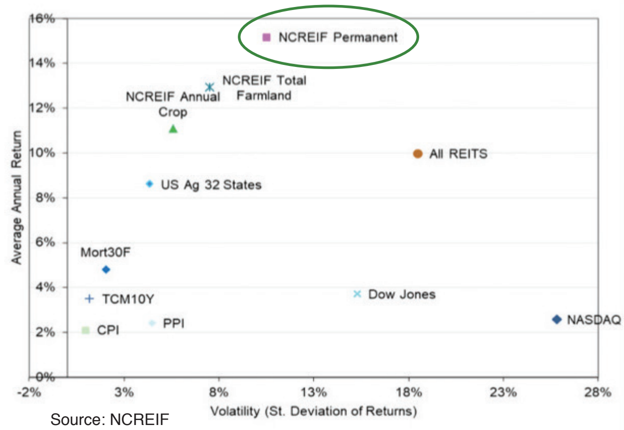
Global fruit and nut production is growing, driven by the increase in demand for "healthy and nutritious" superfoods farmed in a sustainable way, both from consumers in developed markets and also from the growing middle classes in emerging markets. This has helped fuel investment by institutional type investment towards permanent crops.

Institutional farmland portfolios in the 2000s have mostly concentrated on arable crops and to a lesser extent cattle farmland; however in the last two or three years we have seen allocations into permanent cropland increasing considerably. This is for nuts in particular (almonds, hazelnuts, pistachios and walnuts), as well as olives, berries and other fruits.

There are some specialist funds and investment vehicles targeting permanent crop and other higher value cropping. However, a number of the big institutional investors and farmland fund managers are looking for diversification reasons to commit around 20-30+% of their agri-investment allocations into permanent and other higher value crop farmland, usually with secured water.

Because of the long-term nature of the investment and the capital costs required to be spent on depreciating assets, there are considerable barriers to entry. This can benefit the institutional type investor looking to invest at scale. Land preparation, trees and irrigation infrastructure make up 50-80% of the total costs of permanent crop farming projects.

Various Assets - Risk v Volatility - USA 2000-2018



Source: NCREIF

Returns

The attractions of including long-term income flow of permanent crop land in a diversified agricultural portfolio are clear.

In the US during the period 2000 to 2008, the average total return for arable cropland was 11.09% as opposed to 15.17% for permanent cropland (source NCREIF). International row crop farmland provides annual cash rent yields of around 2-5%, as opposed 4-8% for permanent crops, depending on the country and investment type. There are usually much higher annual cash farming returns for those also investing in the operational business itself.

There are greater opportunities to create alpha returns from permanent crops than from arable crops. This could be by developing green field projects and/or also utilising the latest technology and farming production methods e.g. nutrient application by way of drip irrigation, ground sensor controlled irrigation, drone imagery and artificial intelligence, and intensive/super intensive planting of trees.

It is not all a bed of roses though, investors in permanent crops do face the risk of consumer tastes changing by the time they reach full production. So careful long-term market research is required to try and predict long-term consumer habits.

Business Models

Investors are either acquiring existing orchards or investing in green field development projects. With the latter they are looking to benefit from the often considerable arbitrage of the increase in capital value of the land, due to the creation of new orchards with a long-term income stream. Whilst it takes three or more years to become income producing and six or seven years to reach maturity, the twenty-five to thirty-year income flow is attractive.

Most investors to date have invested in the operational businesses, as well as the farmland. However more recently a number of institutional investors have been looking to partner with good operators by investing purely as a landlord, where they own the land, trees and irrigation and other infrastructure, let to the operator on long-term leases (say 20-25 years).

To achieve even better returns, some are investing across the value chain through vertical integration i.e. from the growing, packaging/processing to the marketing of the end product. Whilst other investors are looking to maintain their landlord business model, they aim to capture additional returns with flex leases which enable some participation in the profits of their tenants operating business, as well as perhaps owning packhouses or processing units let to their farming tenants.

Investment Regions

Regions where permanent crops have attracted the most institutional type investment include California, the leading US producer of most high value crops, as well as other states in the US. In California there has been significant investment in converting land growing low value cereal crops into permanent ones, especially nuts (80% of the world's almonds are grown in California) and also wine grapes.

However with California's high-profile water issues and more recently Trump's trade war with China, investors have also been attracted to other parts of the world, including Australia (e.g. almonds, avocados and wine grapes) and New Zealand (e.g. apples, kiwi fruit and wine grapes), Chile/Peru (e.g. avocados, blueberries, apples/pears/cherries, grapes, citrus, olives, nuts, wine and table grapes) and Spain and Portugal (e.g. citrus, olives and almonds).

InvestAg LLP

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