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Time to unlock farms' real value

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AUSTRALIAN farmland and agricultural infrastructure is at a crossroads.

Without access to affordable additional capital in the near term (debt and equity), it will find it difficult to modernise and reinvest to compete and hold current export market shares.

More significantly, it will not be able to take opportunities such as becoming the "food bowl" for Asia. And we won't be able to take the opportunities that may come out of the white paper on agricultural competitiveness just announced by Agriculture Minister Barnaby Joyce.

Additional capital is needed to better compete and to make the new investments for Australia to seize the new opportunities.

There is a question mark on whether this capital can come from existing and more traditional sources.

The mindset, for understandable historical reasons, of banks and institutional investors seems to be that agricultural risks that cause uneven profits do not fit the bank models for lending and the investor models for investing, where short-term predictability and more even returns are weighted over long-term returns.

This can be seen, for example, when there is little competition from Australian investors when assets such as Cubby Station come on to the market.

Yet Australia boasts one of the largest pools of institutionally invested monies in the world, some $1.6 trillion, much accumulated as long-term savings for retirement incomes which has to be invested in diversified risk assets.

It has some clear leaders in investment: the industry funds in the 1990s and more recently the Future Fund in achieving its ambitious targets give confidence that real opportunities will be taken up.

Australia boasts a very profitable banking system and well-capitalised banks.

So what will it take to get a greater level of investment into our farmland and agricultural infrastructure?

The starting point could be to better understand what the overseas global funds are doing. Farmland and agricultural infrastructure is becoming a recognised asset class in the US and Europe. One prediction is that the current inflow of $US28bn into that class will grow to $US42bn in the near term and $US150bn in the medium term.

Among the factors fuelling that growth is that by 2015 an additional 75 million hectares will need to be brought into production to meet global demand. In the last 10 years, only an additional 24 million was brought into production.

Some of this global funds investment is coming into Australia and those investors recognise the underlying and long-term value of farmland and agricultural infrastructure in Australia, including water rights.

Media recently reported that more than $1.5bn has been invested in Australian agricultural land over three years and $3.5bn in the last five years, including acquisitions by pension funds from Canada, Denmark, The Netherlands, Sweden and the US and other funds from Switzerland and the US as well as Qatar's sovereign wealth fund, aggregating Telopea Downs Station through Hassad Food.

This overseas investment into Australia drives demand and helps meet the need for capital, and hopefully will continue to grow in line with foreign investment guidelines.

The first challenge is the scepticism that longer-term returns can be adequate in this sector, given the risk profile. The experience with the listed vehicles that have not fared well in Australia will be pointed to, for example, along with the MIS investments.

What we are seeing overseas and what we should continue to explore is patient capital from pooled funds invested for the long term looking for rates of return above inflation and possibly to be an inflation hedge.

The second is that institutional funds management is a relatively new industry, only recently beginning to invest in less liquid, longer duration, more individual, less informationally complete assets such as agricultural land.

Macquarie Agricultural Funds Management estimated in 2012 that the value of global institutionally owned agricultural land was about $40bn, 4 per cent of an "investable universe estimate" of about $1 trillion and about 0.5 per cent of an estimated total $8.3 trillion global agricultural land value.

Perhaps it is not surprising that despite its rapidly accumulating size from compulsory super contributions, the domestic industry is cautious and as funds belong largely to working families, investment changes to risk/reward take time.

The third challenge is that operational efficiencies in agricultural investments, gained from economies of scale and diversity, have not been easy to achieve. Fractional ownership through a broad base of shareholders has often not fared well. Such forms of ownership have tended not to be rewarded by the market.

It may even be that the high proportion of land held by small owner-operators in Australia has impeded the achievement of scale that institutional investment could facilitate (unlike with forestry, for example).

But financial innovation is the hallmark of successful financial markets and we are seeing strategies overseas of restructures and separation of different parts of these businesses to unlock value and more closely match investors with different risks. The obvious example is the separation of the farmland from the operating businesses.

Finally, there is the lack of regular, reliable, benchmark and comparative data on returns from land and operating returns, so agricultural investments remain grouped with other informationally deficient investments in the ubiquitous "alternative asset allocation" class, along with private equity, venture capital and hedge funds.

It is clear that the creation of a farmland and agricultural infrastructure index for Australia is a step we need and should be able to take in the development of the "market infrastructure" underpinning an asset class.

Steps to make data provision (importantly, including land revaluations annually) and its disclosure a higher priority would be very constructive.

In summary, we think there is now mounting overseas and local information which should prompt a reassessment of opportunities in farmland and agricultural infrastructure and make it its own asset class.

The opportunity exists for investment advisers to work on new structures to unlock value. This is a big opportunity for institutional investors.

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