Market Retrospective

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Reflections of an Asset Class Pioneer

As a pioneer in agricultural investing for institutional investors, Jeff Conrad has a unique perspective on the growth and evolution of the farmland asset class. What follows are excerpts from an interview he recently gave on the topic.

***Q:** Jeff, what do you remember most about the early days of the asset class and how it was perceived by investors?*

A: I came into the sector in the late 1980s on the lending side for John Hancock. Eventually, however, I convinced the company to allow me to launch an investment management unit, the Hancock Agricultural Investment Group, which would make equity investments in farmland for large institutional investors.

Hancock had sponsored some farmland equity opportunities for institutional clients prior to my direct involvement, but, the company had not made a real commitment to building and marketing a dedicated capability. I felt this was the only way it could be successful in the sector so there was a real focus on evangelizing for the asset class — both internally and externally. This happened right on the heels of the "Farm Crisis" and I have some "interesting," some might even call them painful, memories of giving presentations and making pitches to prospective clients during that period.

Then… and Now.

On the left, Jeff as a 15-year old working on his family's dairy farm in Pennsylvania. On the right, Jeff mowing pastures on one of his farm properties in 2017.

About Jeff Conrad

Jeff Conrad, CFA, is the head of AgIS Capital LLC. He was formerly president of the Hancock Agricultural Investment Group, which he founded in 1990. Jeff has been involved in farming his entire life and has been a recognized thought-leader in the farmland and agricultural investment sector since 1987.

During his tenure with the Hancock Agricultural Investment Group, Jeff built the organization, which eventually controlled more than $2 billion of investments and capital globally for an array of large institutional investors. He retired from the firm in 2011 and launched AgIS Capital LLC in 2013. Since then, he and his colleagues at AgIS have raised nearly $1 billion more in commitments from sophisticated institutional clients. Together, the AgIS team is constructing portfolios of agricultural production and processing assets for clients using an opportunistic investment strategy.

Jeff was born and raised on a dairy farm in Pennsylvania, where he still owns crop and timber properties. He is a graduate of Penn State University and Cornell University, where he studied agricultural business management and agricultural economics. In 1995, he co-chaired the development of the NCREIF Farmland Index. In addition to his farmland investment experience, Jeff has more than a decade of experience serving on the investment committees of a multi-billion pension funds and foundations. The insights he has gained from "sitting on both sides of the table" have provided him with a unique perspective on the role agricultural investments can play in an institutional portfolio.

Truthfully, in the early 1990s, investors and their consultants would practically slam their doors in my face. I heard over and over again about how friends or family members had lost their farms during the "Farm Crisis" — and if a "smart, hard-working guy like Uncle Bob got burned, how could anyone make money by investing in the asset class?"

Those who didn't have direct, personal experiences like that had inevitably read stories in *The Wall Street Journal* about how farmers had been ruined by debt, rising operating costs, and falling commodity prices during the early and mid-1980s.

In light of all this negativity, getting anyone interested in the asset class was an exercise in perseverance. Strangely, however, that suited me very well because I am a farmer, too, and we are all optimistic and stubborn by nature!

Since that time, it has been great to see the asset class grow. It also has been gratifying to see many of those investors who recognized the opportunities it was offering prosper and benefit from their early involvement in it. I'm also proud of the sustainable farming methods we helped to introduce with our investment programs — and how our development activities (planting of trees and vines) have increased employment opportunities and the tax bases for the many local communities where we have been active. In the process, I'd like to think we have learned some invaluable lessons.

Q: *Like what?*

A: Well, over the years, I've heard several private market managers who are active in agriculture, timberland and other hard asset sectors begin their presentations by indicating that their asset class is "special" or "unique," as if it were somehow less susceptible to competitive forces. For some reason, this is particularly true in the farmland space.

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All asset classes have different risk and return characteristics, but none of them are "special" or "unique" enough that they can't experience major downturns. This narrative often reflects a rear-view mirror perspective of how one type of asset performed over a certain period. It does not demonstrate a recognition of how the asset class will perform going forward under an evolving set of economic circumstances, which is essential to have if one is to really understand how a particular asset class will enhance the performance of an investor's broader portfolio. Frankly, I have to admit, I used this same narrative early in my career.

Farmland provides some very attractive benefits, such as compelling, risk-adjusted returns and portfolio diversification. It can also help hedge inflation. But other asset classes have these and still other attractive features as well. So what does that mean from the perspective of an institutional investor? I think it means, "I'm happy to have you educate me about the characteristics of your asset class, but please don't insult my intelligence by telling me your sector is special or unique. It is just different from the asset class I'm going to hear about in another presentation from another investment manager 45 minutes from now."

"Comparing and contrasting farmland to other asset categories and understanding its specific value drivers is essential."

Q: *So, looking at farmland, in particular, what is the best way to explain its characteristics and benefits to a prospective investor?*

A: I tell investors and prospective clients that comparing and contrasting farmland to other asset categories and understanding its specific value drivers is essential. Farmland looks and behaves similarly to timberland and commercial real estate, but it may provide stronger current income than these other asset classes. From a capital placement standpoint, individual farmland investments also tend to be smaller than those commonly seen in the timberland and real estate sectors — and this can mean that it may take longer to fully invest an allocation.

I try to emphasize that farmland is an adaptable and flexible asset class that can be used to address a variety of investment needs for a client. For instance, if an investor needs current income and has a moderate risk profile, attaining exposure to mature permanent crops, like established wine grape vineyards and nut orchards, may be an attractive investment strategy. However, an investor that has a stronger appetite for risk and is interested in significant, long-term capital appreciation may find "greenfield" permanent crop development investments more appealing. These entail planting trees or vines that will increase in value as they mature biologically.

Q: *Talking about risk, what about commodity risk? That seems to be an area of emphasis for a lot of investors that are looking at farmland and agriculture.*

A: It is important to understand that commodity prices tend to be cyclical around long-term trends and that asset prices don't always behave accordingly in the near term.

I recently attended a well-regarded agricultural investment conference after having had little conference exposure for a few years and I was struck by how the investment managers who were presenting were essentially using the same pitch for farmland that I used 20 years ago. Based on the data and analyses they provided, it sounded like this farmland stuff was a "sure bet." They were all emphasizing positive, long-term fundamentals like population growth, accelerating income levels and improving diets in the developing world to substantiate their farmland investment theses. The takeaway for anyone sitting in the audience was that farmland was almost guaranteed to be a winner. However, it is important to recognize that these same fundamentals have been in place for more than 30 years and that they don't assure success for anyone who participates in the asset class. The fact that long-term fundamentals are favorable doesn't mean you can't have short–term cycles in which farmland prices are bid up to the point where investors can no longer attain their required returns. Conversely, compelling long-term fundamentals do not preclude farmland prices from falling. A good example of this is what we are seeing right now in the row crop sector, where values have been falling for some time because land valuations had gotten way ahead of income and earnings fundamentals. We're confident that the row crop sector eventually will adjust and that valuations will rebound as farm earnings and income levels begin to grow again. Meanwhile, however, this scenario provides a really good illustration of what I was just talking about. You can't place too much stock in the importance of long-term commodity risk fundamentals when assessing the farmland asset class — or even the attractiveness of a particular investment opportunity.

Q: *What is your view of the NCREIF Farmland Index? Is it an accurate and reliable benchmark?*

A: The NCREIF Farmland Index isn't perfect, but it is a sound measurement tool and the best barometer we have for assessing how the asset class and the managers involved in it have performed. I'd say my biggest frustration and disappointment is not with the index itself, but with how it is used.

In the early days of educating the marketplace about farmland, I got significant feedback about the asset class not having a benchmark. I remember one meeting with a large, public pension fund executive who was seriously considering investing with us, but he was concerned about how he would measure our performance. I recall him saying: "If you produce a ten percent return for me, is that a good return? Could I do even better by investing with one of your competitors?" I couldn't answer his questions and this type of feedback made it clear to me and others in the sector that we needed to create a credible benchmark. As a result, in 1995 I co-chaired the development of the NCREIF Farmland Index. My hope was that it would foster confidence in the asset class and those involved in it. From where I sit, it has helped do that. It currently consists of data from 743 properties that have a total market valuation of nearly $8 billion (as of 12/31/16), so it offers a good representation of U.S. farmland performance. With the growth of the asset class, NCREIF also now offers sub-indexes that capture the performance of property types — specifically annual row crops (corn, soybeans, etc.) and perennial permanent crops (trees, vines, etc.) — as well as commodity types (almonds, walnuts, etc.) — and management styles (leased or directly operated).

A valid criticism of the index is that it is appraisal based. Over time many managers have shifted to more frequent external valuations with most reporting annual third-party valuations. Clearly, this has made the index more robust, but we have to recognize that it is a private market tool and will never have the immediacy and comprehensiveness of a public market index.

Getting back to my original point, however, my greatest source of frustration with the index has been how it is used by the farmland investment management community. Managers either don't have the resources to use it effectively or they choose not to for competitive reasons. Over the years, I have seen many pitch books and performance reports of farmland managers and I'm always struck by the frequency with which they provide stale information and do not use adequate footnoting. Some also tend to select inappropriate sub-index benchmarks against which to gauge their performance. For instance, I've seen managers compare the performance of a row cropland portfolio against the performance of the total Farmland Index, which is clearly like comparing apples to oranges. I have also seen managers use improper regional data sets and irrelevant management style metrics (lease vs. directly operate) to make the case that their performance has been superior. Any manager should be able to develop customized indices that give investors an accurate view of their investment performance. This can be done simply by re-weighting the crop-type mix (row vs. permanent) and operating style designations (leased vs. operated).

"Farmland investors and their consultants have a duty to be involved with the development and use of the index."

All that being said, I also think farmland investors and their consultants have a duty to be involved with the development and use of the index. I often hear investors lament the fact that they can't get an accurate picture of the performance of their investment managers because everyone shows them data that suggests they have outperformed the index. The surest way to debunk that myth is for investors and their consultants to become more knowledgeable about the index and involved in its evolution. I believe that is the only way to ensure that managers are not inappropriately manipulating how the index's data is being used and represented to enhance their prospects of attracting and keeping business.

"A farmland white paper is not an investment strategy..."

Q: *Are there any other competitive myths that you think need to be exposed?*

A: Yes. I might characterize one of them this way: A farmland white paper is not an investment strategy or evidence of one's ability to develop and operate a credible farmland investment program. I have been around for a long time and it is very satisfying to watch the asset class grow and mature. It also has been interesting to watch new managers enter the space because many are pushing the boundaries with more complex and sophisticated strategies and approaches. The downside of this growth, however, is that the farmland investment sector has attracted opportunists who lack the knowledge, skills and experience one needs to be successful in this space. Many slick Power Point presentations have been developed with little thought to the more mundane, but greatly required skills, of how to effectively acquire and actually mange farm assets. These presentations, and the management teams that use them to market themselves, extol the virtues of including farmland in a portfolio based on attractive fundamentals, but they often fail to highlight the critical acquisition and asset management phases of an investment strategy. Those two phases of the investment process will make or break any farmland investment.

There is nothing glamorous about doing a "frost watch" to decide whether it is necessary to turn on the wind machines to protect a vineyard's newly-planted vines — or whether it is necessary to irrigate a tract of soybeans on a particular day. These are the types of ground-level decisions that have to be made every day for a farmland investment to be successful — and they are decisions that can only be made by a team of knowledgeable professionals who have experience managing large-scale, high-value agricultural assets. The slick presentation might result in a manager receiving an investment allocation, but that client's ultimate success will be determined by the manager's ability to source, analyze and price attractive investment opportunities; to develop and implement sound management plans; and finally, to liquidate assets. In other words, it is not the sizzle but the substance that wins the day in this asset class.

Q: *OK... Last question. What is one of the biggest misconceptions investors have about the farmland asset class and how do you address it?*

A: I mentioned this earlier, but I would say it is the size of some of the investments that are being made on their behalf.

Some investors are very surprised to learn the number of transactions that might be required to fully invest a large allocation. Compared to timberland or commercial real estate, the units of investment in this asset class tend to be much smaller. For many years, timberland and real estate investment managers built large portfolios for their clients by snapping up individual assets or entire portfolios valued at hundreds of millions of dollars — and in some case, even billions of dollars. With the exception of a few recent portfolio offerings, it is extremely rare to see an investment in agriculture that exceeds $100 million in size. In fact, based on the NCREIF Farmland Index data, the average farmland asset is valued at slightly more than $10 million. Consequently, the time it can take to build a large farmland portfolio by aggregating a collection of smaller-scale, diversified assets has led some institutional investors to view the asset class as unattractive. Clearly, it takes hard work and patience to successfully construct such a portfolio, but I have been involved in assembling several farmland separate accounts that are now more than 20-years-old — and the clients who own them are still smiling because of the performance they have produced. When this issue comes up with a prospective client, I always like to say to them: "Well, if this was easy, everyone would be doing it!"

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