U.S. Farmland and other Real Assets

A Research Note

Hancock Agricultural Investment Group®

An MFC Global Investment Management Company

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January 2010

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This paper examines the relationship and performance of farmland and other real assets.

Farmland Asset Class Overview

Institutional investors find farmland to be an attractive long-term investment that offers capital preservation, historically strong performance, a current income return component, low to moderate risk and favorable diversification characteristics. Farmland is a major asset class with over $1.9 trillion in total asset value across the U.S., according to the United States Department of Agriculture (USDA). Of that, approximately $300-400 billion is institutional-quality farmland. Institutional investors own approximately $2.0 billion in prime U.S. farm real estate, as measured by the National Council of Real Estate Investment Fiduciaries (NCREIF) Farmland Index as of December 31, 2009.

Crop types fall within two broad categories: row and permanent crops. Row crops are annual crops, and include corn, cotton, rice, wheat, soybeans, grains, vegetables, etc., which must be planted each year, with no remaining value in the plant itself after harvest. Row crops generally provide a lower risk and return profile in the continuum of farmland investing. Permanent crops consist of perennial plantings of trees or vines, including apples, nuts, wine grapes, etc.. In permanent crop investments, a significant amount of the property value resides in the tree or vine as well as in capital improvements such as irrigation systems or structures used to grow the crop. Higher returns and risks are expected for permanent crop investments as compared with row crop investments.

Return on investment varies by crop type, but in general, the return on investment in agricultural land is a combination of operating income and land appreciation. A farmland portfolio can be built to meet different client investment objectives by changing the portfolio's asset mix (row crops vs. permanent crops), management style (lease vs. operated), and geographic (by region, by country) and commodity diversification.

Farmland Risk and Return Features

The following discussion compares the performance of U.S. farmland with that of traditional asset classes such as long-term corporate bonds, long-term government bonds, etc. As illustrated in figures 1 and 2 below, U.S. farmland returns are negatively correlated with returns of these traditional asset class returns, and positively correlated with commercial real estate returns and inflation. Relative to the other asset classes shown in Figure 2, over the 40-year time period shown, farmland has provided attractive returns at relatively low risk.

Figure 1: U.S. Farmland Correlation with Traditional Asset Classes

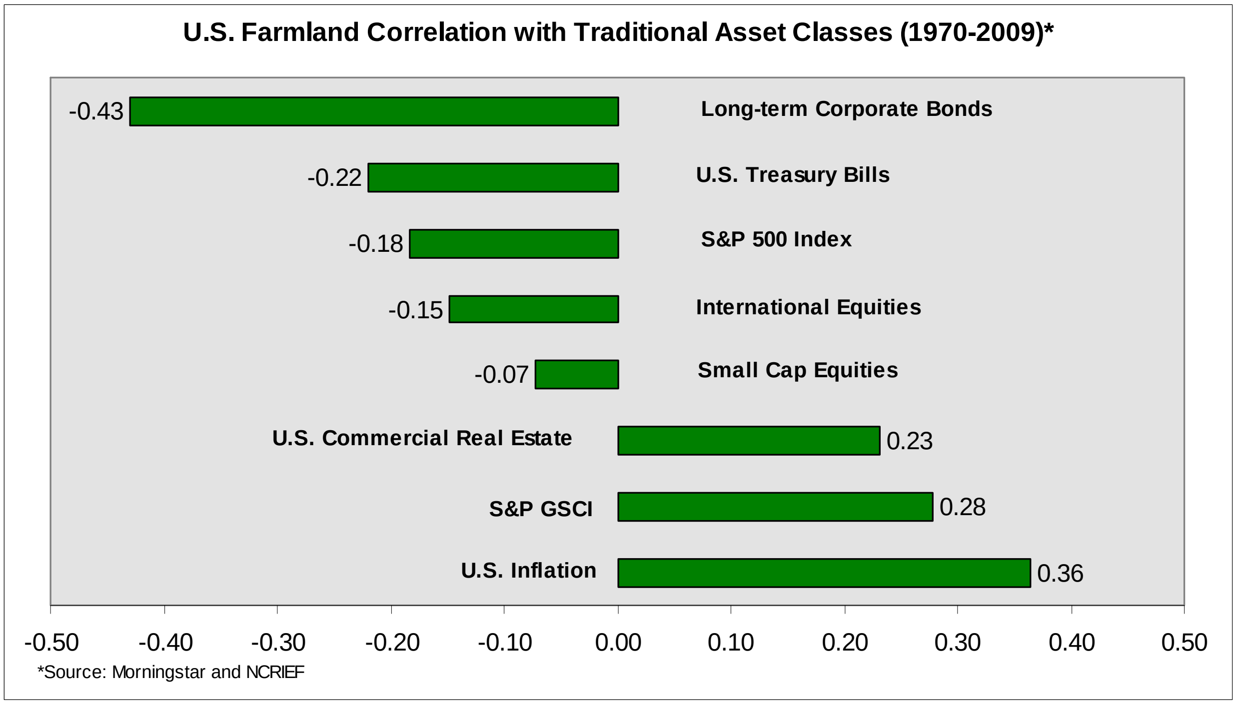
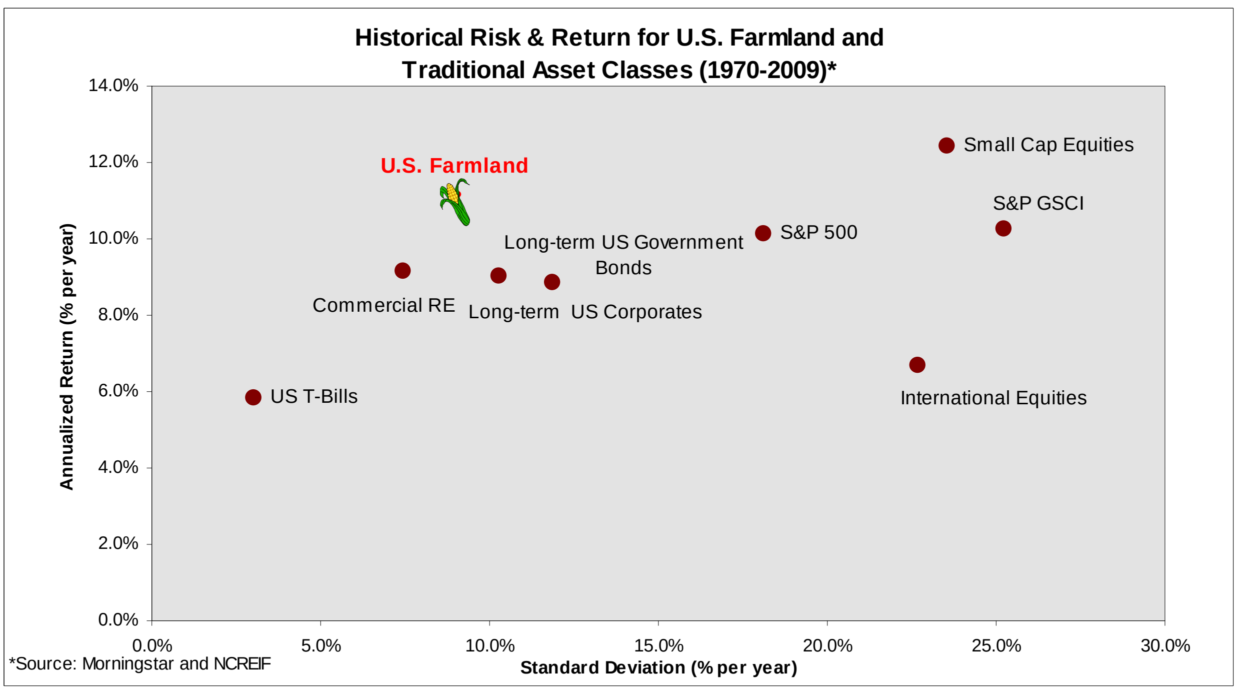


Figure 2: Historical Risk & Return for U.S. Farmland and Traditional Asset Classes



U.S. Farmland and Other Real Assets

How does farmland compare to other real or alternative assets? Farmland historically has exhibited a lower risk profile than other real assets such as commodity derivatives, precious metals, oil and gas.

The nature and structure of farmland investments affect its risk/return profile. Farmland investors receive returns based on either a lease payment from a farmer leasing the land (much like a commercial real estate rent) or revenues from sales of crops grown on the property. Expenses vary by property type and management style.

In today's investing universe, there are many real asset choices for institutional investors to research when looking to add a real asset exposure to their portfolio. Real assets or "alternatives" that are often compared to farmland include timberland, commercial real estate, commodities, infrastructure investments, gold, oil and gas. In Figure 3, below, we compare farmland to several of these real asset classes to the extent that reasonable performance data are readily avaliable for the asset class.

For the 40-year period ended in 2008, farmland portfolio performance has been positively correlated with a basket of real assets as shown in Figure 3. Relative to most of these other real assets, farmland has provided favorable returns at a relatively low risk level over the same time period (Figure 4). Farmland can be directly operated (farmed) or passively leased to a local farmland operator. Farmland returns typically consist of current income from yearly crop sales or net lease payments, plus land appreciation.

Figure 3: U.S. Farmland Correlation with Real Asset Classes

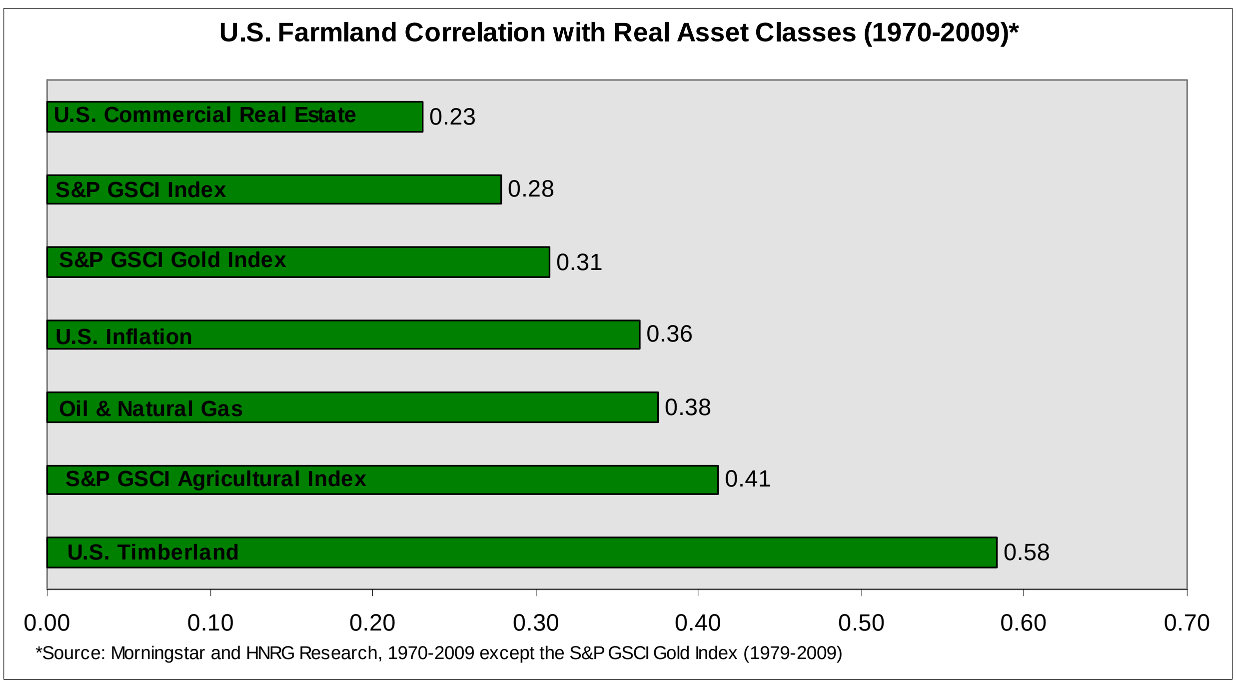
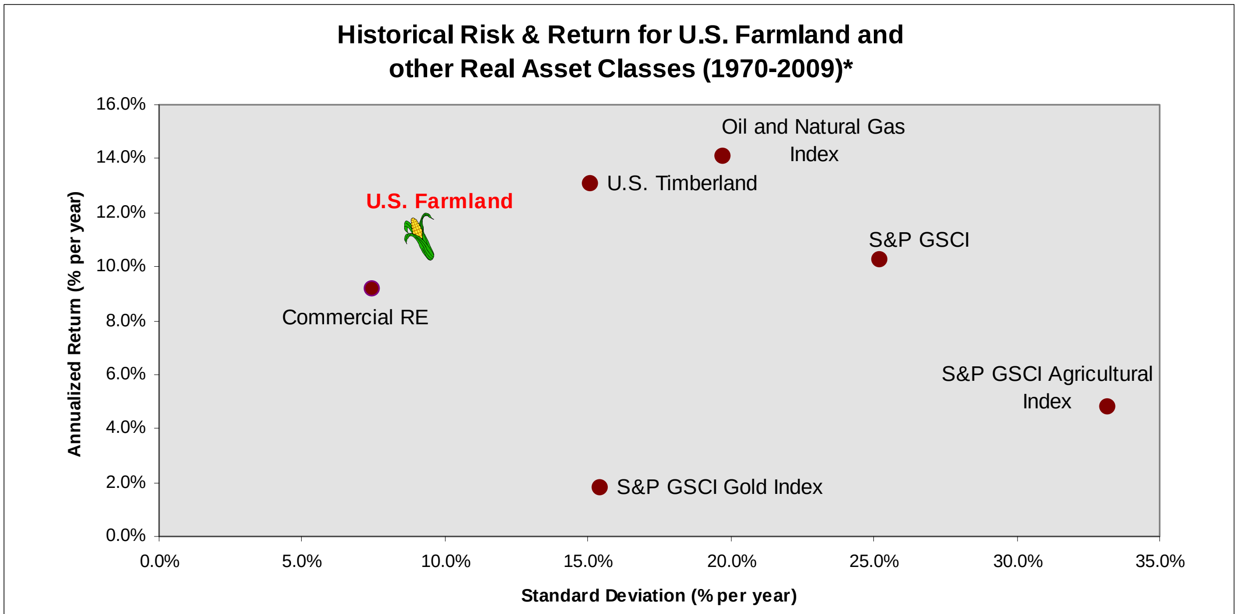


Figure 4: Historical Risk & Return for U.S. Farmland and other Real Asset Classes



*Source: Morningstar and HNRG Research, 1970-2009 except the S&P GSCI Gold (1980-2009)

Institutional farmland is a relatively new asset class, but investing in farmland is one of the oldest investment alternatives. Given its unique characteristics, institutional investors may be unsure about where to place farmland within their portfolio strategy. In our experience, HAIG has found that farmland is typically placed in one of three asset mandates: real estate, real assets or alternatives.

The size of the institutional farmland market is also relatively small compared to other real asset classes, such as timberland and commercial real estate. While the small market size has deterred some investors, other institutional investors have embraced the asset class, seeing advantages in the limited institutional investor influence in the space. The table below provides a comparision of farmland vs. timberland and commerical real estate by market value and observations provided by NCREIF. All data is as of December 31, 2009.

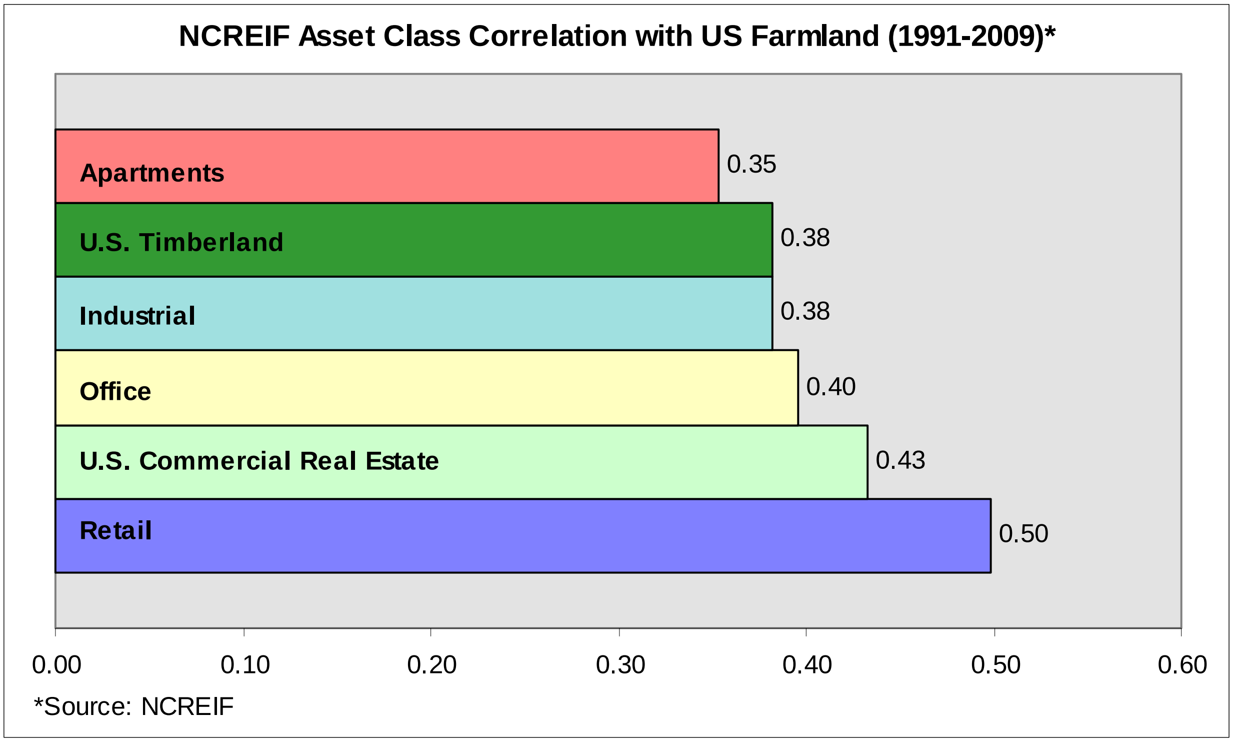
Asset Class	Market Value (in billions)	Observations
Farmland	$2.0	437
Timberland	$23.7	365
Commercial Real Estate	$238.2	6,211

*Source: NCREIF 2009 Fourth Quarter Real Estate Performance Report

While the institutional farmland market documented through NCREIF appears relatively small compared to timberland and commercial real estate, a number of large organizations hold farmland investments not reported in the NCREIF Farmland Index. For example, the Church of Jesus Christ of Latter-day Saints, Jess Jackson of Kendall-Jackson and Paramount Farms hold many thousands of acres of farmland not just in the U.S., but throughout the world. The size and value of these other "institutional" holdings is not reflected in the numbers above, and is estimated at $10-20 billion.

Figure 5 shows correlations among farmland, timberland, commercial real estate and four NCREIF commercial real estate sub-types: apartments, industrial, office and retail. Farmland is positively correlated with these asset classes.

Figure 5: Correlation of U.S. Farmland with Commercial Real Estate and Timberland



U.S. Farmland Performance vs. Timberland and Commercial Real Estate

Farmland offers attractive income and total returns relative to other real property-based asset classes as shown below. U.S. farmland has outperformed both timberland and commercial real estate on a total return basis for the one, three, five, 10 and 15-year annualized timeframes ending December 31, 2009 (Figure 6) and an income return basis for the three, five and 10-year annualized timeframes (Figure 7).

Figure 6: Annualized Total Returns as of December 31, 2009

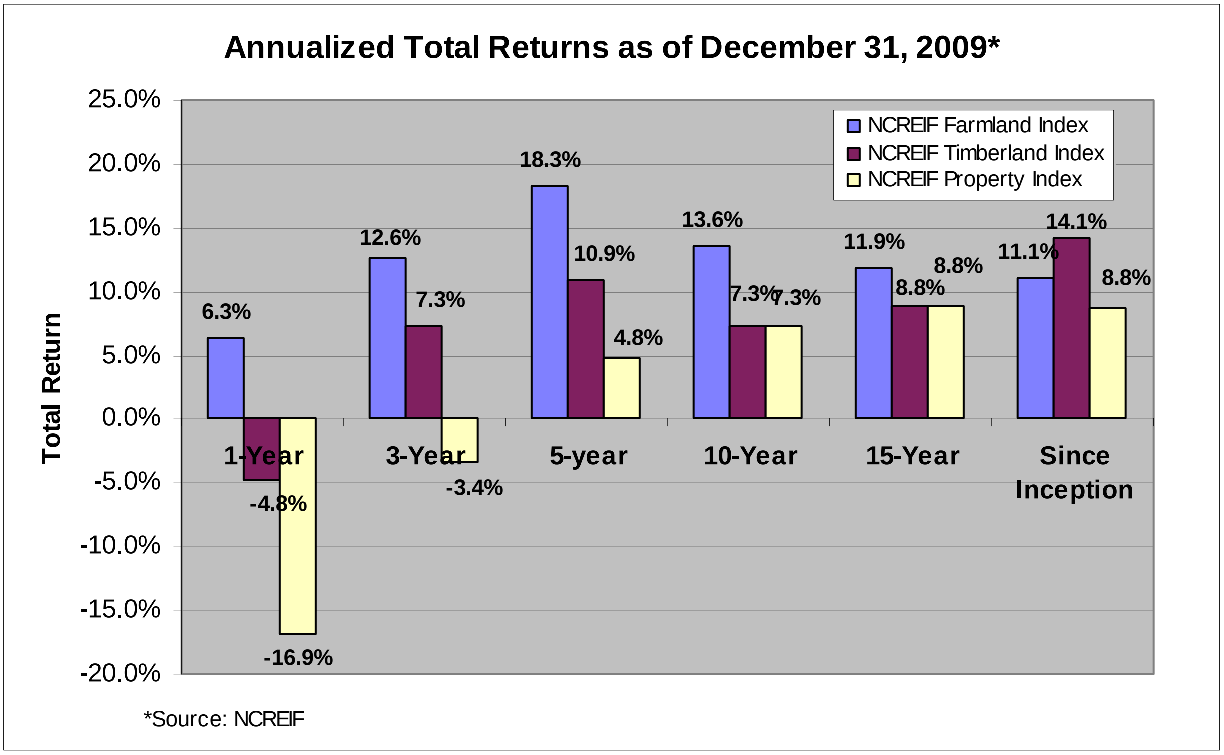
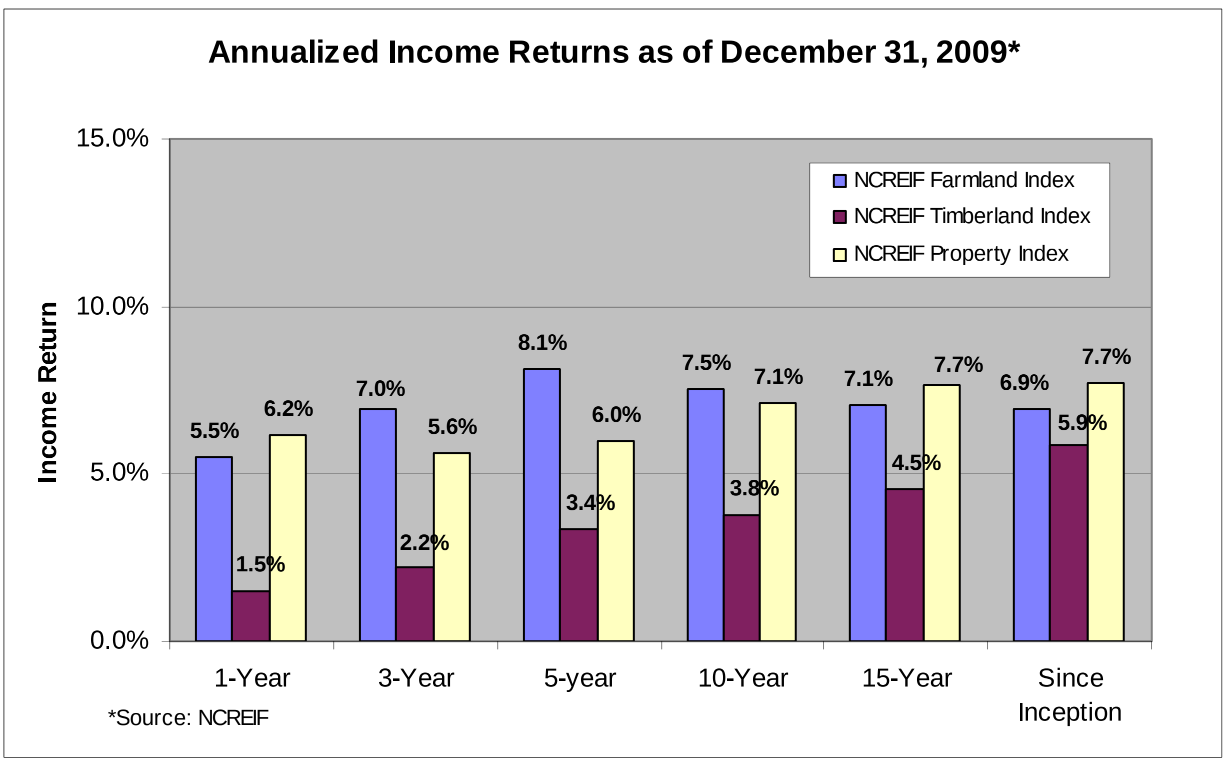


Figure 7: Annualized Income Returns as of December 31, 2009



U.S. Farmland Investment Highlights

- Major asset class providing excellent diversification benefits
  - Negative correlations with traditional asset classes
  - Positive correlation with inflation

- Attractive risk and return characteristics
  - Farmland portfolios provide stable returns at relatively low risk levels

- U.S. agriculture possesses unique competive advantages
  - Superior agricultural products
  - Highly productive farmland

- Farmland typically does not have vacancy rates

- Commercial real estate is driven by the health of the local economy in which the real estate is located, while farmland is driven by global forces:
  - Population growth
  - Global resource consumption growth

- Because the U.S. farm economy is driven to a large extent by exports, farmland investment is an investment in emerging market economies:
  - Growth in emerging markets translates into increased demand for U.S. farm output