

Farms and funds: investment funds in the global land rush

Investment funds show a growing interest in farmland and agriculture. They are buying up land and agribusinesses in developing countries with the expectation of high long-term returns linked to rising land prices, growing populations and increasing demand for food. While the media has reported extensively on the involvement of these funds in the global land rush, the mechanics remain little understood by the broader public. What is the interest and what is driving it? Who are the players and what processes do their investment decisions go through? What are the impacts in recipient countries? And what action can be taken to promote investments that genuinely support local people?

Policy pointers

- **Fund structures are** increasingly being used to invest in agriculture, particularly farmland, in developing countries.
- **Investor interest is driven** by the expectation of high returns linked to rising land values and productivity, and by a desire to diversify investment portfolios and so better manage risk.
- **Where local land rights** are insecure, farmland investments can lead to dispossession of local people.
- **Alternative investment** models may involve investing in companies with expertise and experience in collaborating with local farmers, or funds that support smallholder-based organisations.
- **There is a need for greater** public scrutiny of investment funds in agriculture, and for policy measures that increase transparency and promote investment models that support local farmers and communities.

Funds and farmland

Interest in agriculture as an investment opportunity has gained significant traction since the 2007–08 world food price crisis. Financial players like pension funds, sovereign wealth funds and rich individuals (collectively referred to here as ‘investors’) are increasingly using investment funds as a vehicle to invest in developing country agriculture. Investment funds allow different investors to pool resources to increase their investment options, diversify their investments and reduce their transaction costs.

Some funds focus on trading agricultural commodities such as wheat or corn, aiming to buy and sell at the right time to capture short-term fluctuations in traded prices. ‘Farm to fork’ strategies are popular, with funds looking for medium- to long-term financial gains by buying shares in companies across the agricultural value chain — from businesses engaged in agricultural production to traders, processors and distributors.

Investments in farmland are on the rise. Many investment funds include farmland in their property portfolios, but a growing number of specialised farmland funds are now emerging. A quick search reveals 66 funds investing in farmland today and this is a sector projected to grow fast.

An estimated US\$14 billion in private capital is already committed to investment in farmland and agricultural infrastructure. Analysts expect this figure to double or even treble by 2015.¹ Most of these funds are based in Europe and North America but they are increasingly

looking to acquire farmland in the developing world. A recent survey of investment funds suggests that Africa and Latin America in particular are attracting growing amounts of capital.²

Risks and returns

The rising interest in farmland investments has several drivers. For investors, principally interested in balancing risks and returns, farmland investments are seen as an opportunity for potentially high long-term returns and as a way of diversifying risks away from traditional assets such as equities and bonds.

High returns are expected to come from a combination of rising farmland values and increased agricultural productivity on acquired land. In the United Kingdom and the United States, farmland prices have outperformed stock markets in the past ten years.³ Potential for land values to rise is much greater in Africa, where farmland prices are comparatively low.

Some investors look for land with high yield potential and invest further in agricultural productivity to increase their annual returns. These returns are largely influenced by the prices of agricultural commodities in both export and domestic markets, which can vary greatly from year to year. But investors can protect themselves from short-term swings by leasing out land and transferring year-to-year production and market risks to the farm operator. Investors are often more interested in the long-term trends affecting commodity prices — and these suggest growing returns from agriculture. Growing populations, rising incomes, changing consumer preferences and

Investment funds can be structured to support local farmers

urbanisation, among others, will increase demand for food and raise agricultural commodity prices, fuelling increased returns from farmland.

Farmland investment can also help investors hedge against inflation and is seen as an important contribution to a diverse portfolio that does not entirely rely on volatile equity markets. Diversification is considered key to managing risk.

Of course, farmland investments are not risk free. Starting a new large plantation in often difficult terrains poses major challenges

— in terms of agronomy, logistics, bureaucracy or relations with local groups — and the risk of failure is high. For this reason, some investors prefer to take over management of existing farms, perhaps privatised state farms, and increase productivity by changing management, technologies and agricultural practices.

External risks affecting farmland investment include bad weather, fluctuating commodity prices, changes in regulations or trade policy, and currency risks that affect land prices. Investments in emerging markets, such as Africa, are also thought to be more susceptible to political risks and negative economic conditions.

In general, investors assess the risks and weigh them up against expected returns, taking higher risks for higher potential returns. Investing in farmland in Europe is less risky compared with investments in Africa, but the potential to generate returns is lower. This is because land in Africa is cheaper and there is more scope for increases in land values.

A mix of investors

The decision to invest in farmland and agriculture depends on the asset allocation strategy and targeted returns of the individual fund. In these respects, investment funds are extremely diverse — each has its own risk-return profile, time horizon and governance structure that determines what investments are made where and how.

Many of the funds investing in farmland are private equity funds, which are not listed on a stock exchange. Private equity funds include both institutional investors — who manage money for a wide pool of clients — and wealthy individuals, who can afford to commit large sums of money over a long period of time, for example to allow for a turnaround of an underperforming company.

Publicly available information about these funds is limited, but analysts estimate that around 190 private equity firms are investing in agriculture and farmland today. This is a small proportion of the thousands of private equity firms that exist but is still significant — some 63 of these firms are alone trying to raise US\$13.3 billion to invest in agriculture. Of the 44 agricultural private equity funds in our analysis, a third

focused on Africa. In addition to capital, many of these firms offer agricultural management services, technical assistance, business development advice and expertise in improved agricultural practices.

Institutional investors such as pension funds or life insurance companies control huge amounts of money and often aim for long-term growth. Pension funds tend to be the largest institutional investors in many industrialised economies and they increasingly make agricultural investments. Such investments now total US\$320 billion, compared with just US\$6 billion a decade ago. Agriculture accounts for a small but growing share of pension fund activity: of the US\$32 trillion of assets managed by pension funds, an estimated US\$5–15 billion goes directly into farmland investments.⁴

As pension funds essentially manage the public's money, they are highly regulated and information about their investments is more readily available compared with capital held by rich individuals. For the same reasons, they are under more pressure to reflect environmental, social and governance (ESG) concerns in their investments. In September 2011, a group of pension funds launched a set of 'Principles for Responsible Investment in Farmland', which sets out guidelines for considering these issues.⁵

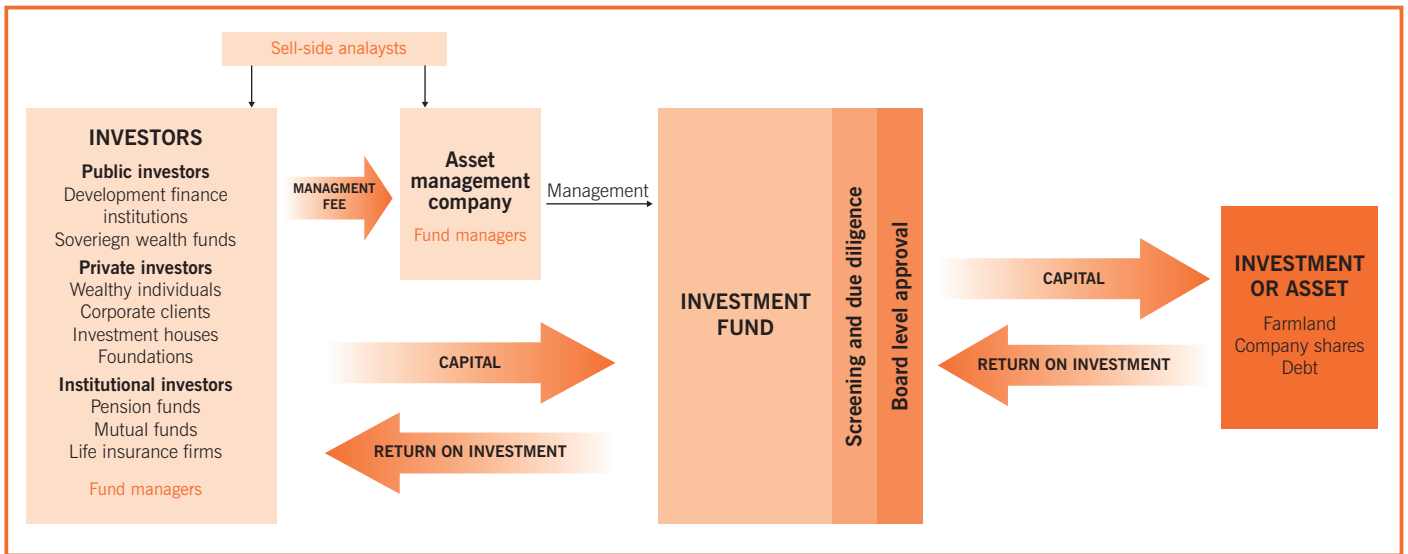
Another type of investor increasingly involved with farmland is, according to media reports, the hedge fund.⁶ Hedge funds are similar to mutual funds in that investments are pooled and professionally managed. But they are much more flexible in their investment strategies and generally adopt an aggressive approach with high levels of speculation. For the most part, hedge funds cater to the 'super rich' and are often outside of conventional regulatory constraints, lack transparency and are less interested in ESG issues.⁷

Sovereign wealth funds — state-owned investment funds that hold or manage public assets for financial objectives — also deserve a mention, though their role in farmland acquisitions in Africa seems to be overstated in public perceptions. They are commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses and receipts from commodity exports.⁸ These funds are unusual as government institutions, in that their management is largely market oriented and separate from other government funds. But they are also unusual in the financial sector because of their government ownership.

The mechanics of investment

Different investors invest in farmland and agriculture in different ways, but all tend to follow a broadly similar process (see Figure). Fund managers generally play a key role in connecting the financial resources held by investors to investment opportunities. They may be directly employed by investors, or provide services to investors through separate asset management

Figure. Investment actors and processes.



companies. For example, an asset management company may set up a farmland fund and seek capital from investors like pension funds or wealthy individuals.

As most fund managers and institutional investors handle other people's money, they have a legal obligation — a 'fiduciary duty' — to ensure that their investment decisions are taken with appropriate advice so as to maximise returns commensurate with an acceptable level of risk. Both investors and fund managers seek such advice from 'sell-side analysts' — industry experts that do independent company, sector and country research and have significant power to influence investment decisions.

Assessment according to economic returns creates pressure for investment professionals to maximise profit to the detriment of other considerations, although recent practice has been more open to ESG concerns. Each investment undergoes a process of due diligence and screening against the fund's investment strategy and sometimes possible ESG concerns, before it is approved by the institution's board. After board approval, a wide range of legal structures are used to provide investors with different forms of ownership and management, with varying ability for investors to enter and exit the investment (and so manage risks and returns).

Once an investment is made, management strategies also vary. In many farmland investments, the fund is mainly interested in holding the land, which it leases to a farm operator for agricultural production.⁹ But some funds pursue more 'hands-on' management strategies, for example through direct control over both an asset management company to manage the fund and an agricultural operator to increase productivity.

Investment impacts

Different forms of involvement in agriculture — from acquiring farmland to buying shares in agribusinesses — will have different implications for recipient countries. In

many African countries, the agricultural sector has long suffered policy neglect and underinvestment, and there is a real need for both money and expertise from the private sector.

But this does not mean that all investment is 'good'. The quality of the investment is critical. Quality can be assessed based on core characteristics of the investment, particularly its degree of inclusiveness — the extent to which the investment incorporates local actors for positive sustainable development impacts (see Are investments inclusive?).

Are investments inclusive?

Assessing inclusiveness involves looking at who controls the business and key assets ('ownership'); who takes what decisions and how ('voice'); who carries what risk ('risk'); and how costs and benefits are shared among stakeholders ('return').¹⁰

By their very nature, farmland investments tend to perform poorly against these criteria:

- **Ownership.** In farmland investments, investors can acquire ownership or long-term leaseholds over large areas of land. While much land in Africa is perceived to be 'empty', suitable land is typically used or at least claimed by local people — and competition for quality land has been growing in many parts of Africa. A combination of weak land use rights and limited public accountability makes local people vulnerable to dispossession.
- **Voice.** Control over key business decisions lies squarely in investors' hands. As much land is owned by the state in many lower income countries, local people often have little say in land allocation decisions.
- **Risk.** The land acquirer carries business risk. While agricultural ventures are inherently risky, investment in cheap land is seen as relatively safe. Political risk can still be significant, although investment funds can partly address this through diversification (acquiring land in different countries). Local people who lose land in contexts where alternative livelihood options are limited risk destitution. Loss of land may also cause loss of social identity and local culture.
- **Return.** Investors get returns through increased land values and productivity. 'Returns' for local people tend to be jobs or social infrastructure. But evidence from recent land acquisitions suggests that jobs are often fewer than expected, short-lived and low-paid. Tax breaks reduce scope for public revenues.

Overall, farmland investments involving large-scale acquisitions may be lucrative for investors, but it is difficult to see how they might genuinely benefit local people. They could also significantly change the agricultural landscape — in Africa, the cumulative acquisition of large areas of land will cause an irreversible shift away from family farming, the backbone of African agriculture, towards large-scale farming.

By contrast, investments involving takeovers of existing plantations, perhaps former state-owned farms now privatised, may increase productivity without adding pressure to the land. Similarly, investments in agricultural equities may provide capital to companies that already have expertise and experience in collaborating with local farmers and communities. Investment funds may also be structured to capture return opportunities linked to working directly with organisations of small-scale producers. These investments may require addressing capacity challenges and transaction costs for funds to be able to operate at scale as well as investments in ensuring beneficial smallholder participation, with fair sharing of risk and reward.

Promoting 'good' investments

Given the weak land rights recognised to local people under many national laws in Africa, short of fully implementing free, prior and informed consent of local landholders and communities, there is arguably no responsible way of investing in farmland in Africa. But investment in agriculture, including by investment funds, can be structured in alternative ways that support, rather than marginalise, local farmers. This includes a wide range of models, including various types of supply chain relationships and ownership of shares by local farmers, which would enable local people to have greater 'ownership' and 'voice'.

There is an urgent need for effective policy measures to promote 'good' investments and discourage harmful ones. Such measures can be taken in investors' home countries, for example by introducing disclosure and transparency requirements. They can also be taken in

recipient countries, for example by creating incentives for more inclusive investment models that involve local farmers; and establishing disincentives for speculative land acquisitions. Private sector operators can play an important role not only by fully integrating traditional ESG concerns into investment decision making, but also by going beyond those concerns to pay greater attention to issues of inclusiveness as measured against the 'ownership, voice, risk and return' framework.

There are plenty of strategies that development actors can use to influence funds to make fairer, greener investments. This includes research and advocacy work for asset owners, sell-side analysts and investment fund boards to ensure that ESG and inclusiveness concerns — including how they can be used as performance indicators — are fully understood and taken into consideration in investment decisions. Targeting sell-side analysts can be particularly effective because their advice is widely used.

There is also a need for greater public scrutiny to increase both government and investor accountability. Greater scrutiny can improve public understanding of the sector, as well as private sector awareness of concerns about inclusiveness. Many investors would admit to knowing little about sustainable development and poverty reduction and would welcome evidence on improved ways to engage with local communities.

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Notes

- ¹ HighQuest Partners. 2010. *Private Financial Sector Investment in Farmland and Agricultural Infrastructure*. OECD Food, Agriculture and Fisheries Working Papers 33. OECD, Paris. See <http://dx.doi.org/10.1787/5km7nzpjl8v-en>. ■ ² Miller, C. et al. 2010. *Agricultural Investment Funds for Developing Countries*. FAO, Rome. See www.fao.org/fileadmin/user_upload/ags/publications/investment_funds.pdf.
- ³ Hawkins, D. 2010. *The World Agriculture Industry: A Study in Falling Supply and Rising Demand*. Hardman & Co, London. See www.hardmanandco.com/Research/Agriculture%20Funds.pdf. ■ ⁴ See Garner, D. 2011. *Farmland Investments and Pension Funds*. DGC Asset Management. <http://dgcassetmanagement.com/farmland-investments-pension-funds>. ■ ⁵ PRI Farmland Working Group. 2011. *Principles for Responsible Investment in Farmland*. See www.unpri.org/commodities/Farmland%20Principles_Sept2011_final.pdf. ■ ⁶ See for example Grant, W. 2010. 'Hedge fund moves into agriculture' in Common Agricultural Policy Blog. <http://commonagpolicy.blogspot.com/2010/01/hedge-fund-moves-into-agriculture.html>, and Kamer, F. 18 May 2011. Hedge Farm! The Doomsday Food Price Scenario Turning Hedges into Survivalists. New York Observer. www.observer.com/hedge-funds-running-farms-05172011. ■ ⁷ Röhrbein, N. 01 Mar 2011. Hedge fund paradox. Investments & Pensions Europe. See www.ipe.com/magazine/hedge-fund-paradox_39585.php. ■ ⁸ For information about sovereign wealth funds, see The International Working Group of Sovereign Wealth Funds at www.iwg-swf.org. ■ ⁹ Wilkes, H., Bailey, I. 2011. International Farmland Markets. *International Farmland Market Bulletin*. Savills Plc. See www.aginvestconference.com/usa/savills.pdf. ■ ¹⁰ Vermeulen, S., Cotula, L. 2010. *Making the most of agricultural investment: A survey of business models that provide opportunities for smallholders*. IIED/FAO/IFAD/SDC, London/Rome/Bern. See <http://pubs.iied.org/12566IIED.html>.

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