Why U.S. Farmland … Why Now … Why Ceres

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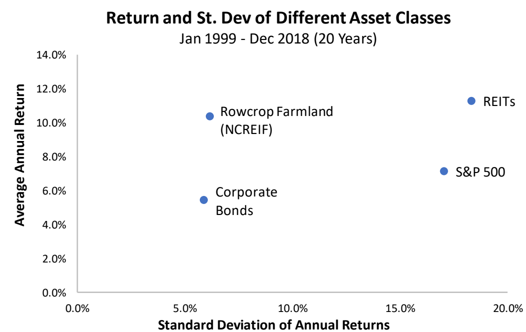
1. Why U.S. Farmland – Uncorrelated Returns with Low Volatility

U.S. Farmland generates *uncorrelated* equity-like returns with very low volatility, providing both attractive risk-adjusted returns *and* effective diversification against the broader financial market. The correlation of Farmland returns with the S&P 500 is -0.024*.



Note: By Farmland, we are specifically referring to land suitable for row crops (such as corn, soybeans, rice and wheat) rather than permanent crops (such as almonds, apples, citrus and wine grapes) which have higher correlation and higher volatility. For a discussion of the differences between row- and permanent crops see A Better Mousetrap – U.S. Rowcrop Farmland.

2. Why Farmland – Long Term Fundamentals

Despite a lot of press over the past few years, institutional ownership of farmland is still very low. Of a total asset class value of approximately $1.8 trillion according to the USDA, institutional ownership is estimated at less than $15 billion – i.e., well below 1%. Farmland clearly has the capacity for substantial institutional inflows over the next decade.

Farmland returns are driven by medium and long run expectations of the prices of the crops grown (e.g., corn and soybeans), but without the high volatility of the commodities themselves. Specifically, rents reflect near- and medium-term prices while land values reflect the long run prices.

Demand growth, driven primarily by rising incomes in China and Asia (as incomes rise, people eat more animal protein which requires more feed – i.e., corn, wheat and soybeans), is approximately twice the rate of productivity growth. Consequently, in order to meet demand, additional capacity (acreage) must be added globally.

Unlike commodities such as chemicals, where new refining capacity is typically lower cost than existing capacity, in natural resources, new capacity is typically higher cost (i.e., the lower cost resources are already in production). Consequently, each successive cycle should have higher peaks and higher troughs. So, while corn and soybean prices go through a normal commodity cycle, the long-term price trend is distinctly upwards.

3. U.S. Midwest – "Park Avenue"

Owning U.S. Midwest properties in a farmland portfolio is the equivalent of owning Park Avenue office buildings in a commercial real estate portfolio. The Midwest owes its premium status to a combination of

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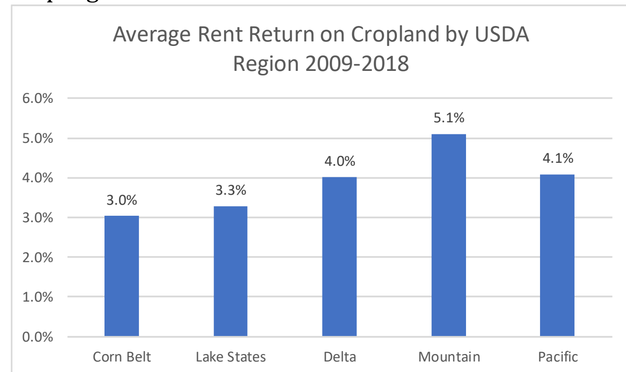
** Returns based on a gross, unlevered property-level basis vs. the NCREIF

factors including highly fertile and productive soils, low cost and efficient rail, road, and river transportation, plentiful water and replenishing aquifers and sophisticated progressive farmers.

Conventional wisdom holds that the Midwest is the least attractive major regional farmland market. This conclusion is based upon lower *average* rent returns and higher *average* land values. The inference is that these reflect a more fragmented and efficient market and less upside.



Ceres sees it differently. We believe that the Midwest is the *least* efficient regional farmland market and therefore offers the *highest* potential returns for an active manager.

The Midwest is not a cohesive single market with many participants. Rather it comprises many distinct local, county- and even township-level markets. In each local market there are only a small number of potential buyers for farmland, leading to inefficiency which can frequently result in mispriced assets.

As a result, most farmland portfolios are significantly under-weight the Midwest. According to the USDA, the Midwest (Lake and Corn belt Regions) comprises approximately 38% of cropland by value, yet it has received only 16% ($725 million) of inflows to the institutional NCREIF Annual Cropland Index over the past 10 years. By contrast, the Delta region which comprises just 3% of cropland by value has received 38% ($1.8 billion) of inflows.

4. Why Ceres

Differentiated Strategy. Ceres's strategy is highly differentiated vs. other agriculture managers:

- Focusing on the Midwest where the market is less efficient and where there are frequently mispriced assets. Ceres has $600 million (approximately 80% of the portfolio by value) invested in the Midwest

- Buying and aggregating smaller properties … Ceres competes with farmers in the Midwest rather than other institutional investors in the Delta or other areas.

- Partnering with sophisticated, progressive farmers who can pay a higher rent. Ceres sources their farmers before buying a farm, and the rent the farmer is willing to pay is a crucial component of the underwriting.

- Adding value through capital improvements (e.g., irrigation, grain storage) and alternative revenue streams (e.g., solar, timber, hunting).

- Internally managing the acquisition and property management functions rather than outsourcing to third party farm managers.

Performance. Following this strategy, Ceres has outperformed the institutional NCREIF Annual Commodity Crop Farmland index by 290, 354, 275 basis points for the past 3, 5, and 7 years.**

Stable, Experienced Team. Ceres' senior portfolio management team has been together since 2010, and the members of the investment committee have been in place since 2012.

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