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## ESG

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# KEYNOTE INTERVIEW

## Reaping the rewards



*Climate change pressures and population growth showcase a decisive role for sustainable agriculture, says **Darren Rabenou**, head of food & agriculture and head of ESG investment strategies at UBS Asset Management*

Halting deforestation and land degradation is a crucial pillar in lessening the impacts of climate change. According to the International Union for Conservation of Nature, forests soak up one-third of the carbon released from burning fossil fuels, while research from the World Resources Institute shows unsustainable land use is the second largest contributor to greenhouse gas emissions after the energy sector.

This reality was highlighted during last year's COP26 climate conference in Glasgow. More than 100 nations, representing 85 percent of the world's forests, pledged to protect these resources and end deforestation by 2030. Countries dominating the global trade in palm oil, cocoa and soya also promised to reduce pressures on forests.

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For UBS Asset Management, advancing sustainable agriculture is already key to its long-term strategy. The investment manager of 280,000 acres across 16 states in the US is a founding member of Leading Harvest, a new ESG agriculture standard that addresses economic, environmental, social and governance matters through farm management. Rabenou describes the opportunities and challenges posed by the sustainability shift.

**Q What makes farmland such an attractive asset class for institutional investors?**

One of the biggest challenges for

investors is finding strategies that are complimentary to the rest of their portfolio, from a diversification and correlation standpoint. It's very difficult to find those assets now. Traditional real estate assets have some correlation characteristics to other parts of the economy, whether it's interest rates or cashflows. But agriculture really is its own animal and has been for a very long time.

You can invest in agriculture in a couple of ways. You can either take on more commodity risk, which stems from owning the actual commodities and tends to be much more volatile. Or you can own the actual farmland, which is our strategy. UBS and our clients are the landlords to farmers who lease our properties.

As a manager, we typically negotiate

a fixed rate lease with a farm tenant or, in some cases, have a revenue share where we shoulder a certain amount of the commodity pricing risk. It really varies property by property, but you end up with pretty steady returns.

That is what makes farmland compelling – it typically has an income yield. One of the biggest challenges has been finding good properties that offer attractive risk-adjusted returns, as there's been a big rush into farmland and it's a newer asset class for many. The food economy is very big, but there are limited ways for institutional investors to participate.

### **Q How do you think about sustainability factors when investing in farmland?**

We're a big proponent of farmers exercising regional best practices, such as no-till farming, crop rotation and other methods. As long-term stewards of land, farmers inherently consider the impact they have on the environment. As asset managers, we prudently invest in prime farmland that has the soil quality, climate and moisture supply needed to produce economically sustained high yields of crops when managed according to these best practices.

### **Q And how do you think about diversification?**

Regional and crop diversification are important from a portfolio standpoint to mitigate weather and regulatory risks, for example. You don't want all your eggs in one basket. We invest in permanent crops, which tend to give a higher return but a higher risk profile. We also invest in vegetable and row crops, which tend to give steady returns but less upside per acre of land. If you look at our aggregate portfolio, it's about 80 percent row and vegetable crops and 20 percent permanent crops. These investments, which are located in 16 states across the US, have exposure to more than 30 different types of crops at any given time.



### **Q How should investors evaluate emerging areas like vertical farming and greenhouses?**

Vertical farming is particularly interesting for countries that need greater food security. A country like Singapore that imports over 90 percent of its food looks at vertical farming as a potential solution, but production costs still need to come down.

Let's also talk about the ESG side of vertical farming. There is a lot said about the amount of water used but there also needs to be a focus on the amount of power needed. I'm yet to hear an argument about how a vertical farm could be net zero. And this includes greenhouses. They use a lot less water and fertilizers than traditional farming, but they're also big power consumers. Adding renewable energy to vertical farming and greenhouse technologies will be important.

### **Q UBS is a founding member of Leading Harvest. How does this initiative help promote sustainability and robust ESG investment?**

Over time I believe Leading Harvest will be the industry standard for farmland management. Promoting and advancing sustainability characteristics is good for both landowners and farmland tenants. Currently, 100 percent of the farmland acres we manage are enrolled in the Leading Harvest Farmland Management Standard. We are undergoing our initial certification audit by an independent third party as we speak.

### **Q Are there areas that you think about other than food sustainability and impact?**

There's also the social impact to think about. As an extension of what we do in farmland, we're starting to think about cold storage. One of the benefits of cold storage is that it helps to keep the cost of food low, which makes food available

to all income levels. This is important because frozen fruits and vegetables generally have the same nutritional value as fresh produce. While fresh might taste better, in many circumstances the higher cost can make availability a challenge for some across demographics.

If you can make frozen fruits and vegetables cheaper, and more available, then you're making a positive impact and changing the health dynamics of the entire population. This is something that food producers need to think about, particularly when they start looking at the ESG components. In addition, the availability of better cold storage can have a significant impact on reducing food waste.

Food waste can also be addressed by changing consumer behavior. Retailers typically only sell fruits and vegetables with uniform size requirements. I have seen statistics where some 50 percent of fruit is destroyed in parts of Latin America that cannot be exported to the US because of specific dimension requirements. Many retailers, require

pineapples to be 10-12 inches high but that's not how they all grow.

If you reduce that waste and change consumer behavior, farmers can make more money and use a lot less water. This has both a positive environmental and social impact on the economics for poor farmers in developing markets.

### **Q How is the risk landscape for landowners different when focusing on organic versus non-organic crops?**

I am a fan of organic farming. However, it is also important to understand the limits to organic farming. It is generally less productive than traditional farming, meaning you're getting less units of crop per acre. For example, if you want Brazilians to focus on organic soybeans that means you have less production per acre, which could mean more deforestation required to create more farmland. This is where there is a debate going on. There has to be a balancing act between the benefits of organic farming and how we go about it.

From an investor perspective, you also need to get paid a premium because of the additional crop failure risk of not relying on fertilizers or insecticides. In some cases, you could have higher labor and production costs which will be passed onto the consumer.

There is the unintended impact on price as well. If organic food is less productive per acre, what would massive conversion of farmland to organic mean for the price of food? And when we think about inflation, how much more can people really afford? I think it is really important for leaders to think about these unintended consequences. Social impact benefits can be achieved by investing in methods to reduce the cost of food for all consumers, especially in developing markets.

### **Q How can technology shape sustainable agriculture?**

Agricultural technology can have a huge impact on traditional farming. If

you can use technology to optimize the use of fertilizers and insecticides, while getting more production from the land, that's a big positive. And especially if you can reduce water usage.

Recently, I was talking to a farmer in California, and he was considering converting his truck fleet to all electric, where the vehicles could be powered by solar panels on his farms. He already has the panels, and it could save him a hundred thousand gallons of fuel a year. If his other farm equipment (tractors, harvesters, etc) can be converted to electric, he could reduce fuel consumption by one million gallons annually.

Some farms could also consider using wind power as a primary energy source, saving millions of gallons of fuel. Then there could be self-driving harvesters. Intuitively, you would think farm machinery companies are thinking about this. I also think automation used in agriculture will grow, especially with farmers getting older.

### **Q What factors are important to consider when thinking about land acquisitions?**

Farmland varies in both its availability and quality depending on the state. And most importantly, certain geographies and temperatures impact what can be grown and what cannot. Also, water can be critical in some of your most productive agriculture states. Water availability contributes a significant portion of the value of the land in many states. When you're looking

*“Regional and crop diversification are important from a portfolio standpoint to mitigate weather and regulatory risks”*

for two sources of water as a backup to ensure you have enough supply, you're going to end up paying a premium for the land. In some parts of the country, mother nature is more consistent with water delivery but it's still a factor in a lot of states.

### **Q What are some of the challenges and risks when investing in farmland?**

It depends on the region of the country. We mitigate our clients' risks through our leasing strategy which separates operational risks from commodity price risks. You want to negotiate fair lease prices with your farmers because you want them to do well and make money. Our leasing strategy provides good alignment between the farmland tenant and the landowners.

### **Q If interest rates rise, how will this help or hurt the asset class?**

In general, higher food prices have a positive impact on land prices. What you'd typically get concerned about is the cost of leverage, but we don't use leverage in our strategy. The question you start asking yourself, though, is how high interest rates could go where they actually negatively affect the operations of farmers. In general, today's farmers are less levered than they were a generation ago.

### **Q How do you anticipate the growth of agriculture within investor portfolios?**

You are continuing to see an interest in the asset class. Global demand for diversified diets and proteins continues to increase, corresponding with population growth and a wealthier world. This underpins higher crop prices and farm income, in turn supporting higher farmland rents and real estate values. In addition to favorable long-term risk-adjusted returns, farmland investments provide inflation protection, diversification, and sustainability to institutional portfolios. ■

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