

18 October 2018

The Standing Committee on Agriculture and Water Resources  
PO Box 6021  
Parliament House  
Canberra ACT 2600

By email

Dear Secretary

### **Superannuation Fund Investment in Agriculture**

I am Tim McGavin, a founder and CEO of Laguna Bay, a top 5 Australian agricultural fund manager with a very good track record and around \$700m AUM. To put this into perspective, I am not a rich fund manager, we are a break-even asset management business. If I wasn't so passionate about Australian Agriculture, I would close the doors and continue to just make money for myself without the hassle of managing money. My passion is driven by a desire to prove that Agriculture is a terrific institutional investment and providing solutions for agriculture's looming problems such as:

- debt saturation (Rural Bank tell us that 98% of capital into Agriculture comes from debt and I believe that Ag debt to GDP is around 130%. Ag needs equity capital desperately and this House seems hell bent on blocking the main source of equity capital available to the sector, foreign investment);
- a retiring farmer (average age approaching 60 years);
- many of my Ag college alumni being forced out of Agriculture as there is no hope of them solving family succession solutions without having access to equity.

My passion also stems from a deep belief that farmland is essential in investment portfolios as, if done well, offers inflation protection, good stable returns, is non-correlated to traditional asset classes. I personally worry that after generations of low inflation and rising equity and bond markets, we may have become complacent about the risks of inflation and if inflation happens, our current superannuation allocations will see a lot of retirees' future living standards drop.

Laguna Bay is solving these issues by leveraging our deep understanding of agriculture to hand pick the best young Australian farmers who need help and empowering them with a unique joint venture structure that provides them with equity, professional managerial support, best practice WH&S, Environmental and Animal Welfare, governance, scale and the benefits that come with that (often lower input costs and better terms for their produce).

I revert back to my original point about Ag asset management being a low margin asset management business. Therein lies one of the barriers. Lower fund management margins leads to less asset managers as the best business case for fund managers is to participate in higher margin products such as infrastructure, property and PE that already has high institutional demand and good asset consultant coverage.

Our target investors are pension funds as we believe this lower hurdle, longer duration capital is most suited to Agriculture. We have tried very hard to attract local super fund investment. Despite having engaged Brookvine, one of the best capital raising firms in Australia to help us, disappointingly, we have not yet raised any capital in Australia.

For some reason agriculture just doesn't hit the spot for Australian super funds and we are thankful for the work this Committee is doing and happy to help to solve the problem.

I will step through the terms of reference quickly.

## Inquiry Terms of Reference

The Committee is enquiring into whether:

### Are there any regulatory requirements imposed that may be acting as a barrier to Ag investment in Australia?

- I am not an expert on the regulatory side of the Super industry mechanics but “freedom of choice” for super fund beneficiaries is certainly creating a disincentive to invest in illiquid assets such as Ag. When there is the possibility of unlimited redemptions, funds cannot invest safely into illiquid assets. It may already exist, but it may pay to review redemption rules and cap them individually and in the aggregate over certain time frames to avoid big flights of capital panicking at certain times in the cycle. I have seen this in the past and it has led to tremendous investment opportunities, when capital, both debt and equity panics during a crisis.

### Is the information required readily available?

- The lack of coordinated and meaningful data is certainly a big barrier.
- Indexes that are meaningful, high integrity and can be relied on are missing. One asset manager said to me “how do I get a bonus if I cannot measure myself against an index?” It is a good question. The industry needs financial support and facilitation to compose and manage these.
- ABARES data is helpful but its very high-level aggregated data. It is my understanding that the majority of Australian farms are sub-scale which distorts the numbers down and the top 20% within the database may be a revolving group which means achieving those numbers consistently may be harder to achieve than it appears at first glance.
- Benchmark data is terrific and should be incentivised across the whole agriculture sector. Not only does it lift productivity, it allows investors to properly measure alpha. The cotton industry does this very well with Boyce Benchmark reports which I believe helps attract capital to the sector and raises sector productivity.

### Are there any other practical barriers to superannuation fund investment into Australian Ag?

- Traditional fund structures are challenging for Ag.
  - An open ended perpetual structure have redemption risks which could exacerbate downcycles as fund redemptions for the selling of assets so could trigger a reflective sell off in assets.
  - Closed ended funds also have problems as it does not make a lot of sense to sell a whole portfolio just because of a fund expiry date. Also, in an illiquid market with regulatory restrictions on some buyers, signalling an exit to the market feels uncommercial to me.
  - The solution is a hybrid structure which superannuation funds are not used to. Add this to a new and unproven (in their eyes) asset class that is not well covered and it adds barriers.
- Incentives - In real asset management, performance fees are paid only upon realisation of the asset. Ag is a long investment due to the high entry costs (stamp duty, etc), illiquidity, lack of buyer depth (FIRB is exacerbating this), and cyclical nature of commodities. Therefore as an asset manager, any performance fees are often decades away. Attracting and retaining staff who can go across to listed equity and PE firms and get performance fees much quicker is more challenging. Funding fund management business growth and co-investment becomes more challenging as you don't have performance fees from older funds to fund new ones. Add to this, the finance industry's focus on short term reporting and incentives, it does not bode well for a long duration asset class.
- Lack of large-scale investment grade opportunities is a challenge. Open, unrestricted, stable, competitive and predictable markets will solve this. Stable and predictable policy is also lacking in Australia which does not help.
- The circular nature of asset consultants lacking investor demand for Ag sector and manager research which means they cannot monetise and scale their work so Ag is not widely covered in the asset consulting sector. When a super fund is interested, most often there is a lack of asset consultant capability, so they are often put off and advised to wait. We get very little traction with asset consultants for this reason, they simply don't have the investor demand to warrant investing time in us.
- The poor performance history of the listed Ag space, various ag schemes and earlier attempts such as some of the mutual funds that invested in the wool industry, late cycle in the late 1980's and left with big losses after the wool price collapse into the mid 1990's has dented confidence in the sector.

- The news cycle of droughts, floods, fires, disease. All of these things can be managed with the right capital, structure and portfolio of assets.
- Perceptions are a problem. Sometimes in finance the person with some Ag history may be from a farm. The reason they are in finance is that they didn't see a future in Ag. Sometimes this was because their family farm was sub-scale and parents encouraged their children away from Ag. These people often become unofficial gate keepers and they don't have experience in the large scale good operator returns that are very different to their personal experiences so they can put capital off unintentionally.
- There are very few "second fund" managers. Funds that have done a full investment cycle successfully so many large institutions maybe waiting to see who to back.
- Complacent asset allocations – We have had a couple of generations who have never seen inflation and only know stock and bond markets to rise. Human nature is to do more of what works and this may have led to an over allocation of dis-inflationary asset classes. My personal view is that this is a big mistake and in a world of PE and low interest rates, inflation poses a big risk and farmland has historically been a very good inflation hedge.
- A lack of understanding of where Ag is at historically. In my lifetime, we have de-regulated our markets, reduced subsidies and market protections to negligible levels and pioneered FTA's. This is intersecting with the emerging market demand growing at much higher rates than the world is used too. I believe that it is not well understood that the macro outlook is very different now.
- In a new asset class, local super funds like to co-invest alongside sophisticated, like-minded and experienced international super funds. Given the current tax changes, this is not possible without triggering a doubling of tax rates for our local super funds. The FIRB restrictions are putting these early investors off which exacerbates the problem.
- The local super funds need to know how they can find full price discovery on an exit. The FIRB rules currently stop this happening so it is possible they are asking, "who do I sell to when I want to exit?"
- Headline risk –Private Ag seems to have a poorer WH&S record, add to this perceptions about environmental and animal welfare issues and super funds may factor in a higher discount rate for this, the volatility and the illiquidity.
- Cost – Unlike infrastructure, property and PE, often agricultural investments lack institutional grade management infrastructure, so the fund manager needs to provide this at their cost. This makes Ag a very high cost asset management business, much higher than traditional asset classes. Therefore, the fees need to be similar to PE but the returns have been lower, with more volatility and are illiquid. The net result is that if an asset manager like Laguna Bay is honest about fees (not hiding them down at the asset level), want to under promise and over-deliver then there is what I call a "truth tax". We will always lose tickets to those that do the opposite and this may not be the best outcome for investors in the long run.
- Finally, capital raisers seem to have a history of over promising and under-delivering.

In summary, if you put all of these things together, there is a lot of career risk for the portfolio manager or asset consultant who puts his hand up and bats for an Ag allocation. I guess it is up to fund managers like Laguna Bay to out-perform other asset classes like we have done in the past and eventually, envy will lead investors to us and reverse this trend.

Perhaps it is also a case, as one CIO told me, that we may be too honest with our philosophy of under promising and over-delivering and also fee transparency. It's hard to compete against the private equity person who is promising 25% IRR's and has a lower headline fee if back-ending fees down into the asset level.

Your faithfully

**Tim McGavin**  
Director