Bonnefield Quarterly Newsletter Q1 2023

Valuing Private Assets in Tumultuous Markets

Investors are increasingly realizing the value of private market and alternative assets in their portfolios for their diversification benefits and low correlation to traditional public market equity and fixed-income products. The case for alternative investments was clearly highlighted throughout 2022 as public market asset valuations experienced volatile and, in many cases, negative performance.

Institutional and non-institutional investors alike saw their private market and alternative asset allocations account for a greater overall portion of their portfolios through 2022, both as a result of the relative decline in value from public markets (the "denominator effect") as well as strong performance in select private market asset classes ("the numerator effect").

However, recent market dynamics have brought two questions to the forefront for private market investors:

1. *"How are my private market assets being valued?" and*
2. *"Can I realize on these values by redeeming my existing positions?"*

These topics are important considerations when evaluating the extraordinary variety of investable assets available to investors and are also topics that Bonnefield, one of Canada's leading farmland and agriculture investment managers, regularly discusses with investors. Our team is keen on ensuring that all investors, irrespective of scale, fully understand and consider the importance of different valuation practices and liquidity features when selecting investments to meet their own investment requirements.

Investing in Canadian Farmland – How can you Mark-to-Market?

Across private markets, fund managers use different valuation methodologies and practices to apply to their investment portfolios. Some use their own internal valuations while others rely on third parties. Some strike new values quarterly while others, every 12 months. It is important for potential investors to evaluate these methods and determine their comfort with, and suitability of, the approach with the asset and investment model.

Over its 14+ year history, Bonnefield has developed and refined our farmland valuation practices in a way to provide confidence to investors. We engage third-party, independent, accredited property appraisers to conduct thorough appraisals on our farmland properties, and those appraisals ultimately form the basis of the quarterly Net Asset Values ("NAVs") of the funds.

Key Considerations

Arm's-Length, Independent Appraisers

The use of third-party appraisers lends itself very naturally to farmland and we are fortunate in Canada to have a strong roster of qualified, independent professionals able to effectively value Bonnefield's farmland properties across the country. The Appraisal Institute of Canada ("AIC") is Canada's leading real property valuation association and is a self-regulating organization that grants the Accredited Appraiser Canadian Institute ("AACI") designation to qualified professionals who meet certain educational and experience requirements. These professionals must complete a series of examinations and continuing education requirements[1]. As appraisers are held to a professional code of conduct by the AIC and are formally educated in the appropriate methodologies to derive property values, we are confident that the appraisal reports produced by AACI-accredited appraisers reflect the appraisers' independent views of fair market value based on defined, objective analysis.

Fact-Based Analysis & Results

Professional appraisers rely primarily on quantifiable, observable data points to support their views of property values. Appraisal reports typically include a detailed analysis of relevant comparable property sale transactions that have occurred in the market, and that set of comparable sales transactions is refined based on geographic proximity, inherent land characteristics (e.g., soil types, crop types, topography, water access, drainage), and recency. Determining market values based on actual, tangible data ensures that appraisal values reflect current market conditions and do not consider speculative views as to where values may trend in the future.

Transparency

In private markets, information asymmetries can act as both a benefit and a risk. Bonnefield maintains a robust, proprietary internal database of farmland sale transaction activity across the country. This data set includes transaction dates, prices, and high-level property information that ensures our team is well-informed regarding historical observable farmland transactions. The database is updated on an ongoing basis. Having access to this information also helps to guide the initial stages of our investment process by enabling our team to quickly assess whether the proposed sale price for a potential farmland acquisition is reasonable in the context of the broader market. This database is also valuable when reviewing third-party valuation reports to ensure that no relevant transactions have been overlooked, which can occur in practice.

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Timeliness of Data

Bonnefield strikes quarterly NAVs across its open-ended farmland funds and these values are informed by staggered appraisals across its properties. Bonnefield ensures each property is appraised at least once annually and can test its core regions and sub-strategies quarterly with this approach. This cadence matches the realities of the industry whereby a single growing season is unlikely to result in meaningful valuation changes within 12 months. However, to ensure timeliness of data, we continuously monitor comparable sales across the country to identify whether recent activity warrants additional appraisals throughout the year. It is our view that this level of rigour is appropriate for ensuring the most accurate reflection of value and ongoing pricing as possible, given the realities of a private, relatively illiquid market for farmland.

Liquidity Considerations for Investors in Private Markets

The discussion above outlines the approach that Bonnefield takes to valuing our Canadian farmland investment portfolios. The valuation approach is one of the key considerations when evaluating a private markets / real asset manager but, just as important is the question of how an investor can realize on value gains over time.

This question has been a particularly 'hot topic' given 2022 conditions, which saw private markets meaningfully outperform their public counterparts. Such a differential in performance can lead investors to request redemptions from their private markets fund holdings – a dynamic that was brought to light by reports of funds such as Blackstone's REIT restricting redemptions in response to a surge in redemption requests. Closer to home, Canadian private mortgage lender Romspen also announced that it was freezing redemptions.

What actually drives these surges in redemption activity?

There is likely no single driver of increased redemption requests but in times of private market outperformance it is possible that investors are looking to realize value in anticipation of a value decline or rebalancing needs in other parts of their portfolio. They may believe that values have not been adjusted on a timely basis and therefore want to redeem before the "correction" occurs. Or they could mistrust the value and want to realize on gains when possible. Both cases speak to the earlier points discussed with respect to the importance of appropriate valuation timing, transparency, and supporting data. Similarly, more institutional managers often manage their portfolio to pre-defined portfolio allocations and outperformance (or underperformance) in any one allocation can result in a shift away from their optimal mix.

Across Bonnefield's open-ended farmland funds, we did not see heightened redemption requests through the end of 2022 despite strong performance of the assets. However, this is not unexpected given:

1. Canadian farmland is expected to outperform in times of high inflation; our investor base was not surprised to see the funds outpace other asset classes in the 2022 inflationary environment.

2. Farmland is a long-term, low volatility asset, and our investors have a long-term time horizon for their investments.

3. Our quarterly NAVs are based on third-party independent appraisals that use a comparable sales approach, thus drawing on actual comparable asset performance.

4. Our funds realize gains on an ongoing basis through regular portfolio management, most often in the form of sales of acreage back to our tenants or local farmers. This can serve as a market-test and enhance investor confidence in the ongoing valuation of the properties.

As Canada's leading agriculture-focused investment manager, Bonnefield strives to be a strong steward of both the farmland properties that we manage, as well as capital invested by our limited partners. We are proud to be a source of long-term capital for farmers and agricultural operators, backed by investors who are committed to the long-term success of Canadian agriculture.

About Bonnefield Financial

Bonnefield is a leading Canadian farmland and agriculture investment manager, providing financing to progressive farmers and agricultural operators through land-lease and non-controlling equity solutions. Bonnefield is dedicated to preserving farmland for farming, and the firm partners with growth-oriented operators to help them grow, reduce debt, and finance retirement and succession. The firm's investors are individuals and institutional investors who are committed to the long-term future of Canadian agriculture. www.bonnefield.com

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1. Appraisal Institute of Canada – Path to Designation