Guidelines to developing a robust leasing or share farming system

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Take Home Messages

Negotiated and executed properly, leases (including flexible rain-based leases) and share farm arrangements have the ability to generate profit and wealth for farm businesses and landowners alike without jeopardising business survival.

Some step by step guidelines to planning and executing a lease or share farm agreement are provided.

To ensure a desirable outcome thorough planning and negotiation should be conducted prior to entering into a leasing or share farming agreement.

The following matters may significantly impact upon your ability to acquire and successfully profit from a lease or share farm arrangement. Each matter should be given due consideration.

Profitability

Determine as accurately as possible the profitability of the venture. To do this budgeting will be essential.

Be realistic about the likely costs and returns and allow considerable margin for error or unforeseen events/costs. If leasing, values must be tied to earning potential not market sentiment.

If the venture does not return profits, then the purpose of the venture must be questioned!

Cash flow

When are outgoings and income anticipated?

Lease payments are usually in advance and in lumpy instalments. This can have a major impact on cash flow.

Under share farming arrangements payments to the land owner are not made until the crop proceeds are received.

Risk / volatility

The level of risk exposure must be clearly determined. Consider all the risks associated with the venture: seasonal / climatic variability; production risk; commodity price; management risk; finance and business risk.

For each risk, analyse who assumes the risk (landowner, farmer, both?), the size of the risk, the likelihood of the event occurring and the impact that it would have were it to eventuate.

Determine the level of reward you require to justify assuming the risks.

Sensitivity analysis

Run scenarios and ask the ‘what if…?’ questions. Test the impact of a range of seasons, lease values, share proportions, yield outcomes etc. This can be done easily and accurately if the initial budget is prepared correctly.

Tenure

Share farming and lease agreements are generally established on a 12 month and 3 year tenure respectively. Such timeframes are insufficient to plan and successfully execute a low-risk, profitable business plan.

Aim for a minimum of a 5 year agreement or at the least a 3 year period with an option of a further 3 years.

The benefits will be present for the landowner too! They will receive increased security through a longer agreement and their asset will inevitably be returned in better condition as the longer the tenure the greater the incentive for the tenant to maintain and improve the farm assets.

Lease / share farming reviews

Ensure that the agreement has the capacity to review the particulars of the lease or share agreement at pre-determined intervals. The relevance of this increases as longer tenure periods are negotiated.

Determine whether adjustment for improvement to capital values can be taken into account. This will provide incentive and reward for the farmer to improve the value of the landowner's asset.

Capacity to succeed

Conduct a skills audit of your business. Do you possess the necessary management expertise, machinery capacity, labour and time to expand? If not, are you able to readily acquire them?

When negotiating or presenting an application to enter into an agreement present the findings of the skills audit. Landowners will view favourably the fact that you have proven management skills, modern plant or sufficient capacity to increase your business's operations, a management plan for their property, access to well regarded advisers etc.

Impact of operating restrictions

Request that all operating restrictions are articulated before entering into an agreement. Often limits are imposed on cropped areas, proportion of crop types, certain herbicide usage etc. Assess the impact that such restriction will have on your businesses ability to make the venture profitable and reflect this in the lease value or share proportion. The more restrictive the agreement is, the more difficult it will be to generate sustained profits.

Water

Accessibility, reliability and quality of water is paramount - now more than ever before! Is there sufficient water to conduct a livestock enterprise? Is water suitable for herbicide application? What is the cost of sourcing alternative water supplies and who bears that cost?

Taxation implications

These are usually of greater importance to the landowner, but investigate the implications of changes upon your businesses primary production status and subsequent tax matters.

Exit strategy

Discuss the notice, costs, penalties and/or compensation owing to each party if for any given reason the agreement can not reach maturity.

Communication

When all else fails……….