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Rural Industries Research and Development Corporation

Successful Land Leasing in Australia

— A guide for farmers and their advisers —

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Successful Land Leasing in Australia

A Guide for Farmers and their Advisers

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By Rod Ashby & Duncan Ashby

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Researcher Contact Details

Rod Ashby & Duncan Ashby
R.G. Ashby & Co Pty Ltd.,
PO Box 916
Geelong VIC 3220

Phone: (03) 5224 2663
Fax: (03) 5229 7566
Email: dashby@rrg.com.au

In submitting this report, the researcher has agreed to RIRDC publishing this material in its edited form.

RIRDC Contact Details

Rural Industries Research and Development Corporation
Level 2, 15 National Circuit
BARTON ACT 2600
PO Box 4776
KINGSTON ACT 2604

Phone: 02 6271 4100
Fax: 02 6271 4199
Email: rirdc@rirdc.gov.au.
Web: http://www.rirdc.gov.au

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Foreword

This report has been prepared to assist broadacre farmers and their advisers with decisions relating to the sustainable leasing of rural land. The economies of scale of a farm business are often directly related to the return on capital achieved – with bigger businesses tending to achieve higher returns. Farm businesses may be able to improve their financial situation by leasing land and investing some of the income into land improvements. This option is especially attractive when it allows for the land to be managed in a sustainable manner.

This publication aims to identify the circumstances under which leasing farm land represents a suitable form of business expansion, with both financial and environmental benefits. It examines how leased land can be managed in a sustainable manner that is fair to both landowner and tenant. The publication includes a case study illustrating these principles with practical, real-world examples.

This project was funded from RIRDC Core Funds, which are provided by the Australian Government.

This report is an addition to RIRDC's diverse range of over 2000 research publications and it forms part of our Dynamic Rural Communities Program which aims to provide R&D that builds capacity in people, industries and communities across rural Australia, including Aboriginal and Torres Strait Islander peoples. The objectives of the Program are to bolster research and development capacity in the agriculture and fishing industries, address future needs for skilled agriculture and fishing labour including shortages, add value to information and communication infrastructure investments in rural Australia, enhance the capacity of rural communities to manage fundamental change, generate knowledge for the benefit of rural people, industries and communities in managing natural resources and support Indigenous rural development.

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Craig Burns
Managing Director
Rural Industries Research and Development Corporation

About the Authors

Rod Ashby - B.Comm, N.D.A., A.F.M., C.P.A.

Rod Ashby is an agricultural consultant and accountant who provides business advice to farmers and policy makers throughout south-eastern Australia. He is also director of several rural businesses, including his own consulting business, R.G. Ashby & Co Pty Ltd. His consulting work focuses on developing efficient and profitable farm businesses, which are structured in a tax effective manner with clearly developed succession and estate plans. His advice incorporates investing both on and off-farm and he is the author of many publications on tax, finance and land-leasing.

Duncan Ashby - B.Comm, G.Dip (PolSci), G.Cert. (Accounting) DFS (FP)

Duncan Ashby is a farm business consultant with R.G. Ashby & Co Pty Ltd and a financial planner with Ashby Financial Consulting. He delivers business advice to farm business clients throughout South Eastern Australia. This involves the preparation of business plans; budgets; and succession planning for farm businesses. He also is involved in the provision of financial planning advice to clients and undertakes corporate governance consulting to a number of companies operating in agricultural industries. Sessional work as a lecturer at Marcus Oldham College is also a part of his annual schedule.

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Executive Summary

What the report is about

This publication aims to identify the circumstances under which the leasing of farm land represents a suitable form of business expansion. It also seeks to identify how leased land can be managed in a sustainable manner that is fair to both landowner and tenant.

Who is the report targeted at?

The information contained in this report will be of value to farmers and farm advisers.

Where are the relevant industries located in Australia?

This book is aimed at broad-acre farming throughout Australia.

Aims/Objectives

There has been a lack of investment in the intellectual property associated with the leasing of land in Australia, and hence many leases are short-term and do not adequately deal with the needs of landowners and tenants; and the land itself. This book aims to address these issues.

Results/Key Findings

Leasing of farm land in Australia is an under-utilised form of land tenure when compared with the high rates of leasing in England and Wales; and in the USA.

After ownership, share-farming and leasing are the most common alternate forms of land tenure in Australian agricultural land. Alongside the traditional forms of these agreements there are a range of hybrid variations to be considered. Traditional lease agreements have been placed under pressure by rising land prices and widely fluctuating farm income, leading to a search for alternatives.

In Australia there are many small farms which do not provide an adequate living for the operators. Many of these landowners could be better off financially if they leased their land to other larger farmers. To run a viable, profitable and sustainable farm business has been a very difficult task in all but the last two years of the past decade for 75% of all farmers.

The returns from farming are extremely volatile even in areas which have relatively little climatic risk such as south western Victoria. Since 2000, land values have risen rapidly above the long-term trend line. This has reduced the productivity of farm land in relation to its value.

Implications for relevant stakeholders

The three main methods for establishing a fair lease rate and term are the rate of return method; the rate per unit of production method; and the percentage of expected gross margin method. All of these methods need to be considered when assessing a fair lease price.

Currently establishing a fair grazing lease is difficult as a result of high stock prices. It is unlikely that tenants will borrow to buy stock for a lease at current prices.

Recommendations

Before a landowner and tenant enter into a lease it is imperative that they identify the taxation and legal consequences as well as undertaking a detailed financial analysis of the lease. Both parties then need to prepare a detailed business plan which identifies the effect of the lease on their business direction and performance. They also need to ensure that all aspects of the lease are thoroughly considered by using a leasing checklist which includes a detailed legal agreement appropriate to their circumstances.

Part 1: Sustainable land leasing in Australia

1. Introduction

This report has been prepared to assist broadacre farmers and their advisers with decisions relating to the sustainable leasing of rural land.

The benefits of leasing were recently articulated by Stephen Wyrill of the UK Tenant Farmers Association when he said: "By separating the functions of land ownership and land management, farm tenancies allow individuals to focus on their specific expertise. Landowners concerned about long-term capital values and sustainable land use can articulate those aspirations through the terms of the tenancy agreements they seek to agree with farm tenants, and tenants can in turn use their business acumen and farming skills to invest in and use the land to create profit from which they are able to pay a sustainable rent."[1]

1.1 Objectives and methodology

Objectives:

- To identify circumstances under which the leasing of rural land represents an appropriate form of farm expansion.
- To define sustainable land management and identify how leasing can be undertaken in a sustainable manner.
- To provide methods for analysing the economics of leasing and identify situations where leasing represents a sound business decision.
- To provide examples of best practice in the process of entering into a lease agreement and managing a leased property.

Methodology

Chapters 1 to 3 of this book provide information on leasing and other land tenure practices in Australia; the USA; and England and Wales; whilst Chapter 4 defines sustainability in a leased situation. Chapter 5 contains an analysis of farm business performance in Australia; and Chapters 6, 7 and 8 provide information on leasing economics, legal aspects and best practice. The information is provided together with practical examples and a major case study in Chapter 9.

The background information will enable the reader to develop a wider understanding of the broader issues involved, whilst the case studies aim to provide a model of how to relate the material to each individual's circumstances.

[1] UK Tenant Farmers Association - National Vice-Chairman - Stephen Wyrill – *Media Release 12 July 2010*.

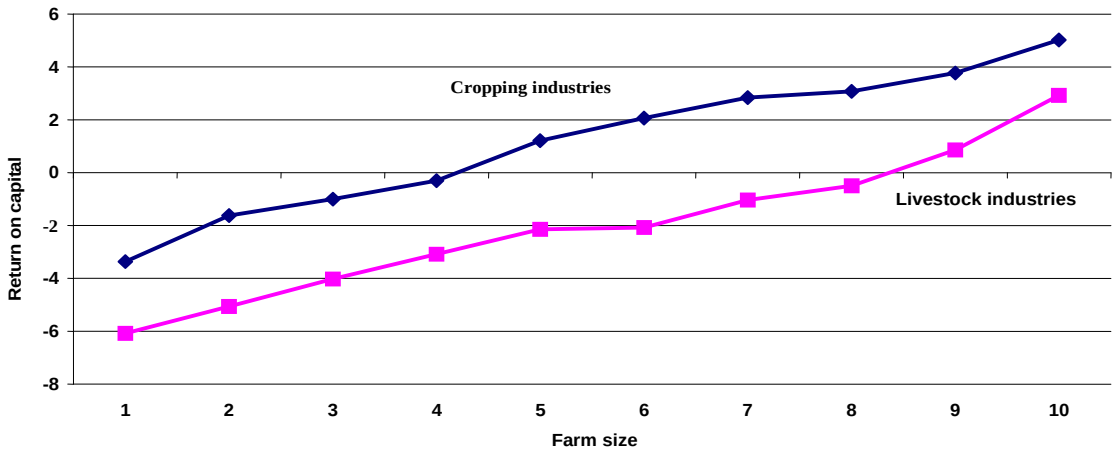
1.2 Why lease rural land?

Since the wool boom of the 1950s farmers have experienced a long-term downturn in rural commodity prices. There have been periodic upturns but overall the long-term trend is down. Farmers have responded to this pressure on prices by either leaving the land or expanding their farm size. Successful farmers have focused on increasing the productivity and scale of their farm enterprises in order to combat this trend, whilst smaller operations have been forced to leave agriculture. Over the last 40 years the number of commercial farms in Australia has nearly halved from approximately 200,000 in the 1950's; whilst the average area of these farms has increased by almost 50% from 2,800 hectares to 4,100 hectares[2].

This trend shows no sign of stopping. In 1998 Australia had 138,654 farms[3]; however by 2004 this number had fallen to 129,154[4]. This change indicates a consolidation of farms as the land under production remained relatively static at around 415million hectares. By 30 June 2009 the number of farms dedicated solely to agricultural production had continued to fall, reaching a level of 120,941 farmers[5]. The fall has continued despite the Australian Bureau of Statistics reducing its qualifying level for the Estimated Value of Agricultural Operations (EVAO) for each farm from $22,000 to $5,000.

On average the larger the farm the higher the return on capital (see Table 1.a); which clearly indicates that farm scale is critical to farm profitability.

Table 1.a "Big is Better"



Farms in the cropping and livestock industries were ranked into size deciles in each year in the period 1991-92 to 2000-01. The average for each decile was then calculated. Farm size was measured in sheep equivalents.

Despite the increase in average farm size there are still many small farms which made little or no income. In 2008/2009 25% of all farms made no farm cash income (see Figure 1.b), whilst another 50% made $50,000 or less. Hence 75% of all broadacre farms in 2008/2009 at best made just enough to cover a manager's allowance of $50,000 per annum.

[2] Dr B. Fisher - ABARE - address to the 24th Biennial Animal Production Conference.
[3] Australian Bureau of Statistics 1997-98 Agricultural Survey 7121.0 released 13 June 1999.
[4] Australian Bureau of Statistics 2003-04 Agricultural Survey 7121.0 released 28 June 2005.
[5] Australian Bureau of Statistics 2008-09 Agricultural Survey 7121.0 released 9 April 2010.

Table 1.b Farm cash income - broadacre farms[6]

Note: average per farm

If a manager's allowance of $50,000 is used as a benchmark, then only the top 25% of farms consistently made income in excess of this allowance.

Many of the farmers making poor returns would have been better off financially by leasing their farms to larger and more profitable farm businesses. They could then work on improving farm structures and also work off-farm, if work is available. This could include working for the tenant.

Leasing has a role to play in producing income for many small farmers who currently make very little from the land and it can provide a better return on capital. If leasing is to benefit both parties it should be appropriate to the businesses long-term needs and conducted in a sustainable manner.

Leasing can be a win-win-win situation

Refer to the case study (chapter 9)

In the case study example if the Jones family leased land from the Browns, the Jones annual cash income increased from $146,000 to $169,000 i.e. an annual increase of $23,000 in an average year and much more in a good year.

The Browns were barely making a living before the lease, now they gross $65,000 from rent; can earn income off-farm; and the land is being better cared for.

The Jones and Browns agree on sustainability criteria for the lease so there is also a win for sustainable farming.

1.3 The availability of land for lease

Currently if agricultural land is offered for lease in Australia there is nearly always strong interest from potential tenants. From anecdotal evidence, demand exceeds supply which may result in unrealistic prices being paid for leases. Many leases are not advertised and result from personal representations by potential tenants.

This book argues that many traditional short term leases (3 years or less) result in bad land management practices, which in turn gives leasing a bad reputation, thereby reducing the availability of leased land overall.

More land is likely to become available if potential tenants work with landowners to develop lease agreements which ensure the sustainability of the land and provide a fair return to landowner and tenant.

[6] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09*, Canberra.

More land would also become available for lease if more superannuation fund managers had the knowledge and foresight to invest in rural land, and then rent it out in a long-term sustainable manner. Over the long-term, productive, well located rural land should represent an ideal investment for a superannuation fund. It provides a modest but reliable income and reasonable capital gain. Perhaps with so many superannuation funds performing so poorly recently then agricultural land may now represent a better option for fund managers who follow the principles set out in this book.

This book is provided to assist potential landowners and tenants to develop long-term relationships which meet the needs of both parties, whilst caring for the land. It is hoped more land will be leased in Australia as a result of the concepts presented in this book.

The benefits of land leasing

The benefits of land leasing were articulated by Stephen Wyrill of the UK Tenant Farmers Association when he said: "Agricultural tenancies provide liquidity to the most fixed factor of production in agriculture – land. Farm businesses looking to expand or contract can use the flexibility of agricultural tenancies to meet their objectives without having to be concerned about issues of land ownership. Also for the vast majority of individuals who would seek to enter the industry, agricultural tenancies remain the only viable route available to them."[7]

Climatic variability

Finally, climate scientists note that primary production is highly sensitive to the impacts of climate change[8]. Adapting to these changes and the variability they produce will be a challenge for agricultural production in the future. When the effect of climate change is added to Australia's already extremely variable climate, the risks to agricultural production are exacerbated. For agricultural producers, the scale of their operations will be vital to allow them to ride out climatic variations; such as the recent drought followed by an extremely wet year in 2010 as experienced in the eastern states. Anecdotal evidence from farmers indicates that small farms will be increasingly offered for rent in the future as a consequence of recent climatic variations. Leasing will be one of the important avenues to allow producers to access the scale of production required.

[7] UK Tenant Farmers Association - National Vice-Chairman - Stephen Wyrill – *Media Release 12 July 2010*.
[8] CSIRO, *http://www.csiro.au/science/Industries-Transforming*.

2. Alternate land tenure practices in Australia

This chapter primarily examines the nature of alternate land tenure practices and the risks associated with each of them. The information is provided to enable farmers that are considering leasing arrangements to compare them with alternatives, in order that they are able to make a fully informed decision. The two key methods of securing land tenure other than ownership are share-farming and leasing.

2.1 Share-farming

A sharefarming agreement is an arrangement whereby a landowner or person in possession of land grants a farmer possession, in order to cultivate the land. The profits and/or produce derived from the farmer's cultivation are shared between them in proportions agreed between the parties[9].

A share farmer is neither an employee nor a tenant of the landowner, so the legal relationship between the share-farmer and the landowner will be quite different from that between a tenant (or lessee) and the owner[10].

The arrangement between the parties to the agreement should be stated clearly in a share-farming agreement. Usually, the share-farmer will be granted a licence to assume possession of; and work the land for the purposes of the proposed venture. A share-farming agreement works best when both parties agree on the farm system to be used.

It is desirable that the contract is in writing and that it stipulates the key elements of the agreement including the following.

Key aspects of a share-farming agreement

- The Term;
- A clear definition of the subject land; and
- The assets to be provided by each party – for example:
    - land and water provided by the landowner
    - machinery, labour, working costs provided by the share-farmer

The responsibilities of each party for management:

Landowner:

- preparing the land to a standard
- taxation and insurance

Share-farmer:

- the production process
- the marketing process
- Taxation and insurance obligations

[9] Source: *http://www.rurallaw.org.au/handbook/xml/ch02s03.php*.
[10] Source: *http://www.rurallaw.org.au/handbook/xml/ch02s03.php*.

Income; cost sharing arrangements; and special conditions

The income and cost sharing arrangements detail how the costs and income are to be shared between the landowners and tenant. As each agreement relates to a particular set of farm conditions, the agreement should provide details to reflect these special conditions e.g. the condition of the land on completion.

It is not necessary that a formal agreement be prepared for a contract to exist. A contract or legally binding agreement may exist by virtue of a course of trading whereby each party has consistently taken responsibility for a specific area over a number of years. However it is highly desirable that a formal written share-farming agreement is prepared in order to minimise disputes and to avoid a presumption of a partnership arising from a joint venture. The agreement should also contain a dispute resolution process with the aim that disputes can be resolved without incurring expensive court costs.

Types of share-farming agreements

Most broadacre share-farming agreements relate to cropping however there is increasing activity in share-farming agreements relating to sheep/cattle enterprises. Crop agreements are usually for one season but may be longer in circumstances where the rotation requires a number of years in order to obtain a fair average return.

There is also significant variation in the level of share-farmer control; the amount of asset provision required by each party; the proportion of income received; and the amount of cost sharing entered into.

Share dairy farming agreements are usually longer term and are discussed comprehensively on the Dairy Australia website – www.thepeopleindairy.org.au[11].

Risks

With a share-farming agreement the landowner and farmer share the risk according to terms of the agreement.

Different crop share-farming agreements have significantly different risk profiles e.g. a 50:50 agreement which shares costs and returns equally is much different from a 30:70 agreement where the landowner incurs no direct costs and receives 30% of net returns.

A summary of the advantages and disadvantages of share-farming and leasing is provided in Table 2.a on page 12.

[11] Source: *http://www.thepeopleindairy.org.au/engagement-reward/share-farming.htm*

2.2 Leasing

2.2.1 The leasing agreement

A leasing agreement is a contract between the landowner and a farmer which gives the farmer the "quiet enjoyment" of the land.

A farm lease is a contract that allows a tenant to hire or rent land for a fixed period of time. The tenants are known as the lessee, and they pay the landlord/s (also known as the lessor) an agreed sum of money for each hectare, or for the farm as a whole. The rent is paid periodically and at a level as agreed between the parties.[12]

A lease-hold interest in land is created by the formation of a lease. This is a contract between two parties: the lessor and the lessee. A lease gives the lessee 'exclusive possession' of real property for a fixed time in exchange for the payment of rent[13]. It is therefore important that the terms of the lease be fully agreed upon before the lessee takes possession of the land. It is essential that the lease be in writing and covers the following aspects.

Essential elements of a lease agreement

- The land to be leased;
- Identification of the partners to the agreement including ACN and ABN;
- The term of the agreement, and any options if available;
- The rent and when payable;
- The process for rent review;
- The landowner's (lessor's) obligations – especially for GST, rates, insurance, stamp duty where applicable;
- The tenant's (lessee's) obligations – especially relating to the care and maintenance of the property;
- A process for dispute resolution;
- Special conditions as they relate to the particular land in question e.g. the maximum area to be cropped, the maximum number of stock to be run, minimum fertiliser rates, etc;
- A process for the ongoing management of the lease agreement – possibly an annual inspection and meeting by an independent consultant;
- The lease may also allow for the preparation of a condition report at the start of the lease;
- Who pays for the agreement – usually this is shared;
- Any guarantees provided.

[12] Source: *http://www.rurallaw.org.au/handbook/xml/ch02s04.php*
[13] Barron, Margaret, 2009, *Fundamentals of Business Law*, McGraw Hill, Australia p317.

2.2.2 Common leasing problems and risks

The main problems associated with leasing are the level of risk experienced by the tenant. Another problem which occurs frequently is that the land available for lease is in a run-down condition and is in need of capital input before it can be managed sustainably.

This section focuses on the risk aspects whilst chapter 6 analyses the situation where capital is needed at the start of a lease.

With a lease agreement the landowner is entitled to the rent, as agreed, irrespective of the income earned from the land. The landowner's main risk is that the tenant or lessee might get into financial difficulty and be unable to pay the rent. It is therefore essential that the lessor only accepts a tenant who is in a strong financial position and/or is guaranteed by people with adequate assets.

It is important that potential tenants have adequate working capital, as a lease always requires an increase in a tenant's working capital.

As the tenant takes the risk of how much income is earned from the property, the risk and the rewards are the tenants – *this is evident in Case Study 2.1 which is a grazing case study which illustrates the effect of a drought on the first year of a lease for grazing land. You will note also the extra working capital needed by the tenant.*

Illustration of leasing risks - the affect of drought on a tenant

In the following grazing example (Case Study 2.1), drought in the first year of a lease impacts on the result: Income fell by $20,000; Feed costs increased by $42,000; and the budgeted surplus of $56,000 became a deficit of $6,000; i.e. Working Capital decreased by $62,000. The tenant also needed capital of $27,000 to conduct the lease.

Case Study 2.1: The risks of leasing – a grazing case study

A farmer leases a 300ha grazing property for three years. The **capital** needed to establish the lease is as follows:

Stock capital required

- 10 DSE/ha @ $80/DSE
- 300ha x 10 DSE/ha = 3,000 DSE x $80/DSE = $240,000

Budget assumptions

- The lease costs $140/ha per annum (paid quarterly in advance) = $42,000 per annum.
- $12,000 of fertiliser must be applied ($40/ha.)
- Wool Income = 3,000 DSE = 1,200 ewes, 1,200 Dry Sheep = 2,400 x 5kg x $6/kg = $72,000
- Sell 800 Lambs at $80 per head = $64,000.
- Including operating costs the farmer estimates that the lease needs $40,000 for working capital.

Total Average Capital Required

Stock	$240,000
Working capital	$40,000
TOTAL average capital	**$270,000**

The farmer experiences the following outcome in the first year. The business experiences poor sheep prices and high feed costs as a result of drier than normal conditions.

Outcome in Year 1 – Budget versus Actual

Income	**Budget**	**Actual**	**Difference**
Wool	$72,000	$60,000	($12,000)
Sheep sales (800)	$64,000	$56,000	($8,000)
TOTAL Income	**$136,000**	**$116,000**	**($20,000)**
Payments			
Lease Cost	**$42,000**	**$42,000**	**$0**
Fertiliser	$12,000	$12,000	**$0**
Sheep costs – shear, crutch, vet, etc.	$18,000	$18,000	**$0**
– feed	$3,000	$45,000	**$42,000**
Overhead – interest, travel	$5,000	$5,000	**$0**
Total Working Costs	**$38,000**	**$80,000**	**$42,000**
TOTAL Payments	**$80,000**	**$122,000**	**$42,000**
Margin before management allowance	**$56,000**	**($6,000)**	**($62,000)**

Notes:

- The cash loss incurred needs to be funded and therefore it increases the amount of working capital required.
- Sheep feed = 3,000 DSE x 3kgs/hd/wk x 20 weeks = 9t/wk x 20 = 180t x $250/t = $45,000

2.2.3 The taxation impacts of leasing

The decision to lease land can have a range of taxation impacts for both the tenant and the landlord. Two of the most important effects are on the primary production status of the landowner and the capital gains tax implications for the landowner if they decide to sell their land at some point.

Primary producer status

A primary producer who leases out land and no longer undertakes primary production activities will no longer be able to claim the tax advantages associated with being in primary production. The main disadvantages are that a primary producer cannot average rental income and certain expenditure of a capital nature which is deductible to a primary producer in the year of expenditure is not subject to an outright deduction. Such expenditure may still be eligible for depreciation however. A comprehensive list of the primary producer concessions is provided below.

If a landowner retains some land in order to retain the primary producer status the landowner needs to seek professional advice on the scale of operation needed to satisfy the ATO. The decision is made on a range of factors which include, but are not limited to whether the activities have a significant commercial purpose or character; the size or scale of the activities; and whether the activities result in a profit.

Primary producer tax concessions:

- Annual deductions over 10 years for the cost of telephone lines;
- Accelerated write-off for new horticultural plants and grapevines;
- Three year write-off for expenditure on water facilities;
- Outright deduction for landcare operations;
- Special deduction for timber depletion (and other timber industry concessions);
- Tax deferral in relation to double wool clips, and spreading of insurance recoveries for livestock and timber losses;
- Spreading or deferring the losses due to the forced disposal or compulsory destruction of livestock;
- Income averaging for individual tax payers; and
- Income equalisation benefits under the farm management deposits scheme.

Capital gains tax impacts

A primary producer who leases out land may lose access to both small business concessions and the Capital Gains Tax (CGT) concessions which are available for ‘Active Assets’, being land that is farmed not leased. The laws relating to active assets mean that if the farm land loses this status then the farmer will not be able to take advantage of the 15 year exemption; the 50% reduction; the retirement exemption; or the roll-over exemption for a replacement property.

The rules for small business concessions have been changed after lobbying from the agricultural sector, which protested over the negative impact they had on leasing decisions. The result is that a CGT asset now satisfies the ‘active asset’ test if the asset is an active asset of the taxpayer for half the period from when the asset was acquired through to the CGT event, or if the asset is owned for more than 15 years, then it was an active asset for 7.5 years. Therefore land owned for 20 years and farmed as an active asset for the first 7.5 years before being leased out, still qualifies as an active asset for small business concessions.

Farm land leased to a connected entity, such as a family member on an arm’s length deal, maintains its active assets status as long as the farm land is used for ‘business purposes’ such as farming. However leases are likely in many cases to be to an entity other than a connected entity or affiliate, meaning this exclusion is of limited benefit.

The 15 year exemption allows a taxpayer to disregard the capital gain if they meet the small business concession rules; have owned the asset continuously for 15 years; and the taxpayer as an individual or significant individual of a company or trust is over 55 and the event happened in connection with their retirement or they are permanently incapacitated.

If a farmer does not qualify for the 15 year exemption then they may pursue the 50% CGT reduction allowed for active assets (on top of the 50% already in place for the discount method).

The consequences of the loss of the tax advantages needs to be carefully assessed case by case; and the tax implications for the individual need to be determined before entering into the lease.

2.3 Other options

In addition to share-farming and leasing a landowner has other options available if he or she does not wish to manage the land directly themself.

Contracting

The use of contract farmers is becoming increasingly important particularly in the cropping industry.

Under a contract cropping agreement the landowner agrees with a contractor for a fixed price per hectare to grow, manage and harvest the crop. The agreement may or may not include an incentive if good crop results are achieved. This method has relevance when the cost of machinery ownership is such that it is more economic to use a contractor.

Joint venture

A farmer may wish to enter into a joint venture with another business to enable the undertaking of a project which was not possible individually e.g. two companies or trusts or partnerships may combine. The new structure provides synergies to the undertaking.

The options for joint venture agreements are numerous and individual agreements need to be prepared for each set of circumstances.

One option for operating a joint venture is a unit trust with a company used as trustee. In a unit trust returns to unit holders are made in direct proportion to their unit holdings.

2.4 Land tenure conclusions

Each of the options provides strengths and weaknesses, however leasing is the only option that provides continuing access to farming for the tenant provided the agreement is of sufficient duration.

This is well put by Stephen Wyrill of the UK Tenant Farmers Association when he said: "Whilst share farming, share partnership and contract farming arrangements are all helpful at the margin, it is only within the security of an agricultural tenancy that farm businesses, without access to owned land, can become established, remain sustainable and improve."[14]

Table 2.a The advantages and disadvantages of share-farming and leasing

Entity	Advantages	Disadvantages
Share-farming		
Landowner	• Has a say in the use of the land; • Reduce need for labour and machinery and hence reduce need for working capital; • Capacity to undertake work for which prior capability did not exist; and • Continues to benefit from any land capital gains.	• Is not responsible for the day to day work and the quality of that work.
Share-farmer	• Much less capital needed • Shares the risks of operations	• In a 1 year lease may experience a loss without the chance to recoup it.
Leasing		
Landowner	• Fixed income paid at regular intervals; • No loss in "bust" years; • Minimal working capital required; • Capital gain on land still available; • Minimal labour required; and • May retain use of some assets e.g. Homestead.	• No benefit from "boom" years; • Loss of primary production status for tax purposes; • May not use the land except as determined in the agreement; and • Land value may be decreased if a sale is needed during the lease term.
Tenant	• Less capital required; • Land cost fixed for term of lease; • Permits the spreading of overhead costs – e.g. machinery for cropping; • Greater economies of scale; and • Permits capital to be invested in non-farm cost.	• Significant fixed costs which must be met irrespective of farm production and income; and • Risk of droughts, poor production and poor prices all remain with the tenant.

[14] UK Tenant Farmers Association - National Vice-Chairman - Stephen Wyrill – *Media Release 12 July 2010*.

3. Lessons from the USA and England and Wales

The tradition of leasing agricultural land has been a strong one in the UK and to a lesser extent the USA. This chapter is included in order to identify any lessons that can be learned from the UK and USA. The USA and UK were selected because they both have sophisticated agricultural industries of which land leasing is an integral component.

3.1 Leasing of rural land in England and Wales

The leasing of agricultural land has been an important component of agriculture for hundreds of years. It has long been recognised as an important system of enabling landlords with land, capital and a long-term perspective, to work with tenants who have working capital, farm and business expertise, for theirs and the land's interest.

Leasing in the UK has been dominated by legislation since the first Agricultural Holdings Act of 1875. This Act introduced statutory compensation to tenants and methods of resolving disputes. The legislation was based on practises which had already evolved in Lincolnshire and was aimed at ensuring equity between landlord and tenant.

The legislation was continually changed especially in the post Second World War era when Britain was short of food and every effort was made to encourage production. Improved benefits to tenants culminated in the introduction in 1976, of tenants being given succession rights for two generations after the original tenant. This right was withdrawn in 1984 for new tenancies but continued for those already in existence. Throughout the period from 1908 to 1998 there was a decline in both the area and number of holdings which were subject to a farm business tenancy.

The value of land subject to long-term tenancy is often discounted by as much as 50%, which reflects the low demand for land subject to a long-term lease. The number of rented holdings in England and Wales in 1992 amounted to 24% of holdings, 35% by area. (Source: MAFF Survey). In 1995 a new Agricultural Tenancies Act was introduced to provide individuals with much greater freedom to make arrangements which suit their particular circumstances, and had the overriding aim of encouraging the leasing of rural land.

The three main overriding criteria behind the drafting of the legislation were:

- To provide an enduring framework;
- To encourage the letting of land; and
- To de-regulate and simplify.

It was drafted after wide industry consultation and tried to provide balance between the interests of landlord and tenant. It represents the collective wisdom of many professional managers and should be of interest to Australians who are contemplating the leasing of land. Specifically the act deals with a range of issues including:

- Removing tenant's fixtures and buildings;
- Parties freedom to agree to a rent review procedure;
- Statutory rent review procedure;
- Appointment of an arbitrator for rent reviews;
- Compensation for tenant's improvements;
- Compensation for planning permission;
- Consent for improvements; and
- Amount of compensation.

The Royal Institute of Chartered Surveyors (RICS) had a major input to the Act. This profession has no equivalent organisation in Australia. In order to gain access to equivalent knowledge in Australia, it would generally be necessary to contact appropriate lawyers, consultants and rural real estate agents. RICS is increasingly useful to landlords and tenants because they are now legally able to draft leases, a function which was previously only allowed to be performed by lawyers.

To determine the Act's impact on the leasing of land, a survey was undertaken by the Central Association of Agricultural Valuers (CAAV). The main findings of the survey were:

Almost 1 in 5 new farm business tenancies were on land not previously tenanted

- 87% of the old tenancies that ended were re-let as farm business tenancies
- The average length of all farm business tenancies is almost 4 years and 9 years for fully equipped holdings
- Less land is now leaving the tenanted sector
- Sales to sitting tenants are the main reason for land leaving the sector

A survey published by RICS in 1996 found that more farm land is becoming available for tenancies.

These statistics seem to confirm the anecdotal evidence gained from talking to various land owners and tenants, which suggests that landlords and tenants are keen to continue leasing land provided they have freedom of contract. They would all have agreed with Paul Pridmore a spokesman for the RICS when he said: "A flourishing tenanted sector is vital for the prosperity of UK agriculture".

It is interesting to note that in a country which has been heavily regulated there has been a move to free up the process of agricultural tenancies and that this freeing up has had a positive effect on the willingness of landlords and tenants to enter into agreements.

In 1998 the length of agreement was predominantly around 4 years for land with no structural improvements and 9 years for farms complete with buildings. These periods are often shorter than some older tenancy agreements but longer than those frequently occurring in Australia. (Source: Annual Survey of Tenanted Land MAFF)

The British system now has a strong combination of legislation which allows a degree of freedom of contract; and an industry with the expertise to deal with the complex issues of valuation and arbitration needed in the event of dispute. The latest figures show the changes support tenant willingness to access farm land. Tenanted land in formal and informal arrangements makes up 40% of the total agricultural area of England and Wales in 2010[15]. Tenanted land in Great Britain has maintained its position of importance in agricultural production.

[15] UK Tenant Farmers Association - National Vice-Chairman - Stephen Wyrill – *Media Release 12 July 2010*.

3.2 Leasing rural land in the USA

Rural leasing agreements in the USA are characterised by great diversity. Whereas in the UK the leasing of land has tended to be dominated by legislation, in the USA government authorities have tended to allow the market forces to work out agreements to suit landowners and farmers.

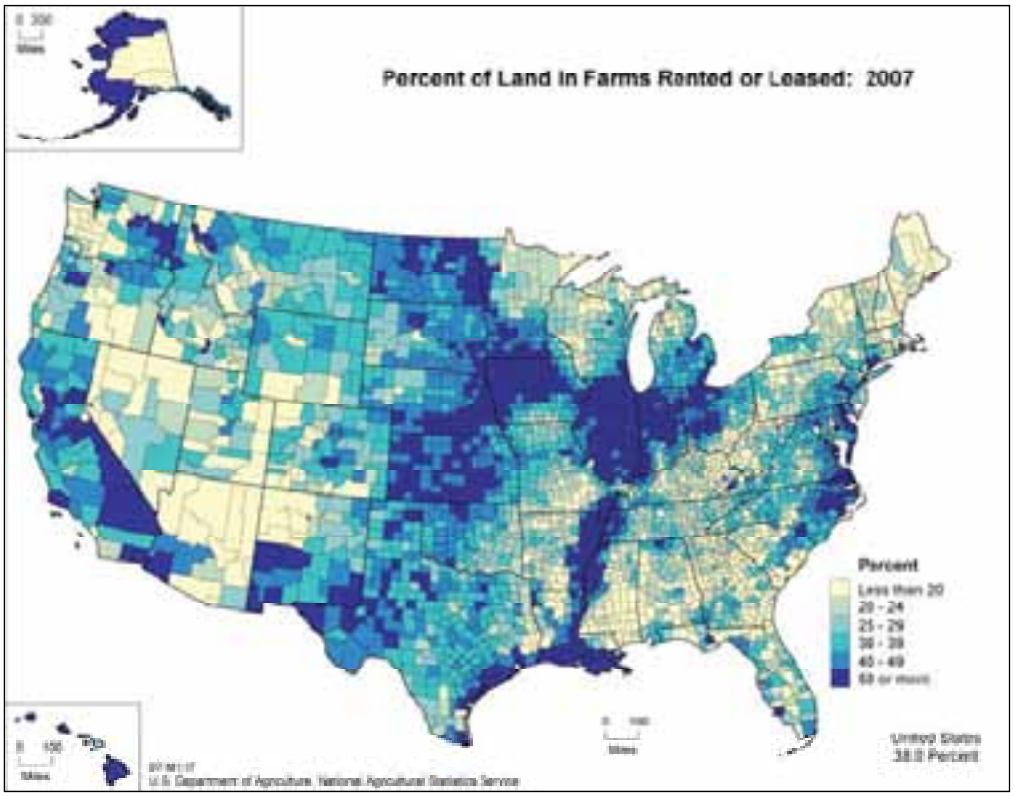
The diversity of the agreements frequently reflects the diversity of the different agricultural enterprises to which they relate. Hence we see different types of agreements for almost every type of agricultural production as shown below in Table 3.a.

Table 3.a Lease agreements for types of agricultural production

Cropping	
	Dry-land Cropping
	Irrigated Cropping
	Irrigated Lucerne

Grazing	
	Breeding Beef Cows
	Breeding Sheep
	Dairying
	Dry-land Grazing
	Fattening Beef Cattle
	Fattening Sheep

Land farmed by a tenant in the U.S.A. makes up approximately 38% of the total land under agricultural production in the country. As can be seen from the map below[16], this percentage rises dramatically to over 50% in certain regions such as the mid-west, where cropping is the predominant form of production.



[16] www.agcensus.usda.gov – *2007 Census of Agriculture* – US Department of Agriculture

The majority of U.S. leases tend to be of a short term nature and are frequently for one or two years. For most of the years leading to the 1985-88 period these agreements were commonly either:

1. A cash rent fixed per year or per cow
2. 50:50 share-farming agreements

In this period, the agricultural industry in the USA experienced great difficulties and land prices fell dramatically. Many farmers were losing money and the focus for those entering lease agreements was to deal with the risk on an equitable basis. This experience is very similar to what has occurred in Australia throughout the early '90s; lending credence to the notion that what happens in the USA today occurs in Australia 5 - 10 years later!

An example of a 50: 50 share-farm agreement is provided in Table 3.b from an article by Dr N.L. Dalsted and Paul Gutierrez of Colorado State University.

Table 3.b Example of a 50:50 share-farm agreement for irrigated corn in USA

Tenant's costs	$/ac	Landlord's costs	$/ac	Total
Fertiliser (50%)	40	Fertiliser (50%)	40	80
Herbicide (50%)	10	Herbicide (50%)	10	20
Irrigation energy (50%)	30	Irrigation energy (50%)	30	60
Custom combine (100%)	22	Seed (100%)	25	47
Insecticide (100%)	10	Irrigation lease (100%)	25	35
Fuel, oil, lube and repairs (100%)	25			25
Misc. overhead (100%)	13			13
Total	**150**		**130**	**280**
Percentage of Total Costs	**54%**		**46%**	

Overhead costs are not included in Table 3.b, in this example the landowner provided the land and pays its associated overheads - rates, repairs, insurance and so on. The share-farmer provides labour and machinery and the costs are divided up as shown above. The income is divided 50:50.

What is perhaps of most interest to Australian producers is the way in which the industry responded to these problems. At that time, articles on agricultural economies appeared in the media focussing on the **equity** of agreements, and how to deal with losses when and if they occur. In trying to arrive at suitable solutions Feuz, Dalsted and Gutierrez focussed on the risk of the enterprise - there being 3 main ones:

- The production risk
- The market risk
- The ownership (financial) risk

They analysed the leasing of beef cows using different budgeting techniques to identify the different risk impact on three different leases.

Examples of three different types of leases of breeding beef cattle:

1. A cash lease
2. When a fixed number of calves are sold by the share-farmer
3. A percentage of the calf drop is sold by the share-farmer

Their analysis illustrated that different agreements impacted differently on the type of risk borne by each of the landowner and farmer, and highlighted the importance of undertaking a thorough analysis of the likely costs and returns before deciding on a lease agreement that is fair to both parties and provides a level of risk which is acceptable to each.

They also reflect a willingness on behalf of US landowners and farmers to discuss openly what constitutes an equitable distribution of income. Perhaps it is because the participants are more optimistic about a positive result and usually face less risk than producers in Australia. Regardless of the reason, this approach has relevance to Australia.

The lesson therefore that Australians can best learn from the US situation is that a comprehensive analysis of the likely costs and returns needs to be undertaken by both parties to a lease, before it is entered into. It could be said that this does occur at the moment - to some extent - although from anecdotal evidence the process seems to occur in an adversarial manner. It is my experience however that this approach often results in one or other of the parties suffering under the lease and the land is often run down during the term of the tenancy as a result.

3.3 Lessons from the USA and UK

Given the significant role that leasing plays in the UK and USA and the extremely poor returns experienced by many Australian farmers it may be useful to discuss why leasing does not play a more significant role here.

In the USA many rural landowners who lease land earn most of their living outside agriculture. Non-farm work in regional areas is more available in the USA than in Australia where the population and opportunities are largely focussed on the major cities. Additionally government subsidies have the effect of cushioning prices and providing more reliable returns. Likewise in the UK relatively stable prices and a reliable climate provide to give lessor and lessee more confidence. This greater degree of reliability does not adequately explain why leasing is not more prevalent in Australia. The terms and conditions of the lease need to be adjusted to reflect the conditions.

Two major impediments stand in the way of leasing. Firstly many traditional leases have been only short term and frequently for three years. The terms and conditions of the lease are often badly constructed and result in poor land management practices and reducing fertility and productivity. Hence leasing has acquired a bad name in rural communities and many landholders feel that they are degrading the land by leasing it out.

Another cultural reason lies in the association of “landlord and tenant” with the old English feudal system which many early Australians were keen to escape. The importance of owning one’s own home in Australia is reflected in the need to own all of the land that you farm – irrespective of the economics of doing so.

In addition the investment in intellectual capital associated with leasing is very poor. Many rural leases are managed by stock and station agents who frequently have little knowledge of land management or economics. They obtain their income from commissions and are frequently focussed on short term returns. It is also relatively rare to find a solicitor with any genuine understanding of these issues.

There are many aging farmers in Australia who would be much better off – both physically and financially – by leasing their land to a modern farm business manager. Frequently there is no need for the landowner to leave the farm as the farmhouse is often not needed. The landowner must be willing to give the “quiet enjoyment” of the land to the tenant.

Given the enormous scope for the expansion of this subject in Australia there is a significant role for the rural consultant to play in the establishment and management of land subject to lease.

4. Defining sustainability in a lease situation

This chapter discusses the meaning of sustainability and how it can be measured in the management of agricultural land.

The meaning of sustainability is vitally important in a world with finite resources and an increasing population. Communities are lobbying governments to ensure that development occurs in a sustainable manner and has minimal impact on the environment.

4.1 Background

Man has evolved over thousands of years from living as a hunter gatherer to developing the first farm systems. The earliest farm systems involved the cultivation of wheat, which increased food production and enabled the establishment of permanent settlements.

The prosperity of these settlements depended on a reliable food source which in turn depended on sustainable farm systems. Throughout history civilisations have waxed and waned which in part was influenced by their ability to maintain productive farm systems. There are thousands of farm systems around the world which have been developed to make the best long-term use of the available resources. These systems can be simple and have low inputs such as the crop/fallow/ley systems used in Europe for hundreds of years, or they can be complex and involve considerable ingenuity and personal labour such as the rice terraces seen in many areas of Asia and used for more than a thousand years. Perhaps the longest sustainable system has been in Egypt associated with the annual flooding of the Nile. A system which worked well until the Aswan Dam was built.

Whether or not a farm system will survive in the long-term depends on the natural depth and richness of the soil, the soundness of the biological processes, and on the ongoing inputs from man. These inputs are of course influenced by the cost of labour and other inputs and the value of the produce. Unfortunately most Australian soils are naturally shallow and infertile and hence inputs and management are particularly important.

Hence the issue of the sustainability of farm systems is closely linked to economics. In this chapter we are seeking to establish a method of measuring the sustainability and profitability of farm systems, but we will start by providing a modern definition of sustainability.

4.2 Definitions and principles

A simple definition of sustainability on farms is as follows: A sustainable farm system is one which does not degrade but maintains the current natural resource base. Such farms are as productive or more productive in the future as they are today.

This definition is a **minimalist** view of what constitutes sustainability. It focuses largely on the farm itself and not on the environment in which it is located. Hence using this definition a farm system could maintain or improve its own production but may have an adverse impact off-site in the catchment environment in which it is located. This definition also does not deal adequately with repairing a degraded natural resource base.

The Standing Committee on Agriculture and Resource Management (SCARM) and its predecessor the Standing Committee on Agriculture (SCA), which advises the Federal government on natural resource management issues, provided the following definition in 1991.

SCARM Definition of Sustainability:

Sustainable agriculture is defined as: **"the use of farming practises and systems which maintain or enhance; the economic viability of agricultural production; the natural resource base and other ecosystems which are influenced by agricultural activities."**

This definition includes economic viability and also considers the impact of the farm system on the ecosystem in which it is located. Hence it is a much broader and more acceptable definition than the one considered earlier, and is the definition which we will use in this book.

The SCARM developed five guiding principles in order to assess sustainability. (Refer Table 4.a)

Table 4.a Five principles of sustainability, SCARM, 1998

1. Farm productivity is sustained or enhanced over the long-term.
2. Adverse impacts on the natural resource base of agricultural and associated ecosystems are ameliorated and minimised.
3. Residues resulting from the use of chemicals in agriculture are minimised.
4. The net social benefits derived from agriculture are maximised.
5. Farming systems are sufficiently flexible to manage risks associated with the vagaries of climate and markets.

Later work by SCARM recognised the important interrelationships between financial ecological and social issues, and the impact that agricultural activities have on the quality of regional and downstream environments.

This definition developed by SCARM together with the five principles was developed to assist with national policy development.

It is also useful to consider the role of Natural Resource Management (NRM) skills as a component of the skills needed by a farm manager, and to view sustainability from an entirely ecological perspective.

Modern farm management requires at least five sets of interlinked skills[17]:

1. Production Skills
2. Financial Skills
3. Marketing Skills
4. Self and Staff Management Skills
5. Natural Resource Management Skills

In this chapter we are specifically interested in natural resource management (i.e. sustainability) and the way it links with the other skills to create profitable and sustainable systems.

Sustainability and Legislation

The NSW Agricultural Tenancies Act 1990 has also attempted to define sustainability in the leasing setting. It states that its aim is to encourage agricultural landowners and their tenants and sharefarmers to have regard to the principles of ecologically sustainable development in farming practices; and to maintain sustainable agricultural production; and prevent the degradation of the environment.

The NSW Agricultural Tenancies Act 1990 defines "sustainable agricultural production" as agricultural production that complies with the following criteria:

a) responsiveness to consumer needs for food and fibre products that are healthy and of high quality;
b) the taking into account of the cost of production, including environmental costs, and pricing that reflects those costs;

[17] Blackburn et al, Farmsmart Resource Manual, pub Rural Resources Group Pty Ltd.

c) the protection and restoration of the natural resource base on which agricultural depends;
d) the prevention of adverse on-site and off-site impacts on the environment and any sector of the community;
e) be flexible in order to accommodate regional differences and changing economic, environmental and social circumstances such as drought or terms of trade; and
f) financial viability.

The Act states that these features of sustainable agriculture should be considered as a package, and no single feature should predominate over the others.

From these definitions and principles it is clear that sustainability encompasses many facets. In this chapter we seek to incorporate all of the principles outlined in order to analyse existing farm systems and develop new systems incorporating the use of new technology as it evolves.

4.3 Indicators

Extensive debate has occurred amongst scientists about the need for and use of indicators of sustainability.

If a farm system is to be assessed as being sustainable then it is necessary to identify relevant criteria which indicate sustainability over time. Walker[18] provides a framework which sets out the steps required to ensure the success of a catchment health indicator program (see Table 4.b). He also provides health indicators for Australian agro-eco systems and emphasises the notion of providing a **report card** which assesses the **condition** and **trend** in key indicators (see Tables 4.c and 4.d). Walker believes that the notion of health indicators is a more useful concept than the less precise one of sustainability.

This work by Walker drew on the earlier landmark publication *Indicators of Catchment Health* by Walker, J. and Reuter D.J., published by CSIRO in 1996.

[18] Walker, Dr J., *Conditional health indicators as a proxy for sustainable indicators*, Technical Report No 6/97 July 1997, CSIRO.

Table 4.b The steps required to ensure success of a catchment health indicator program

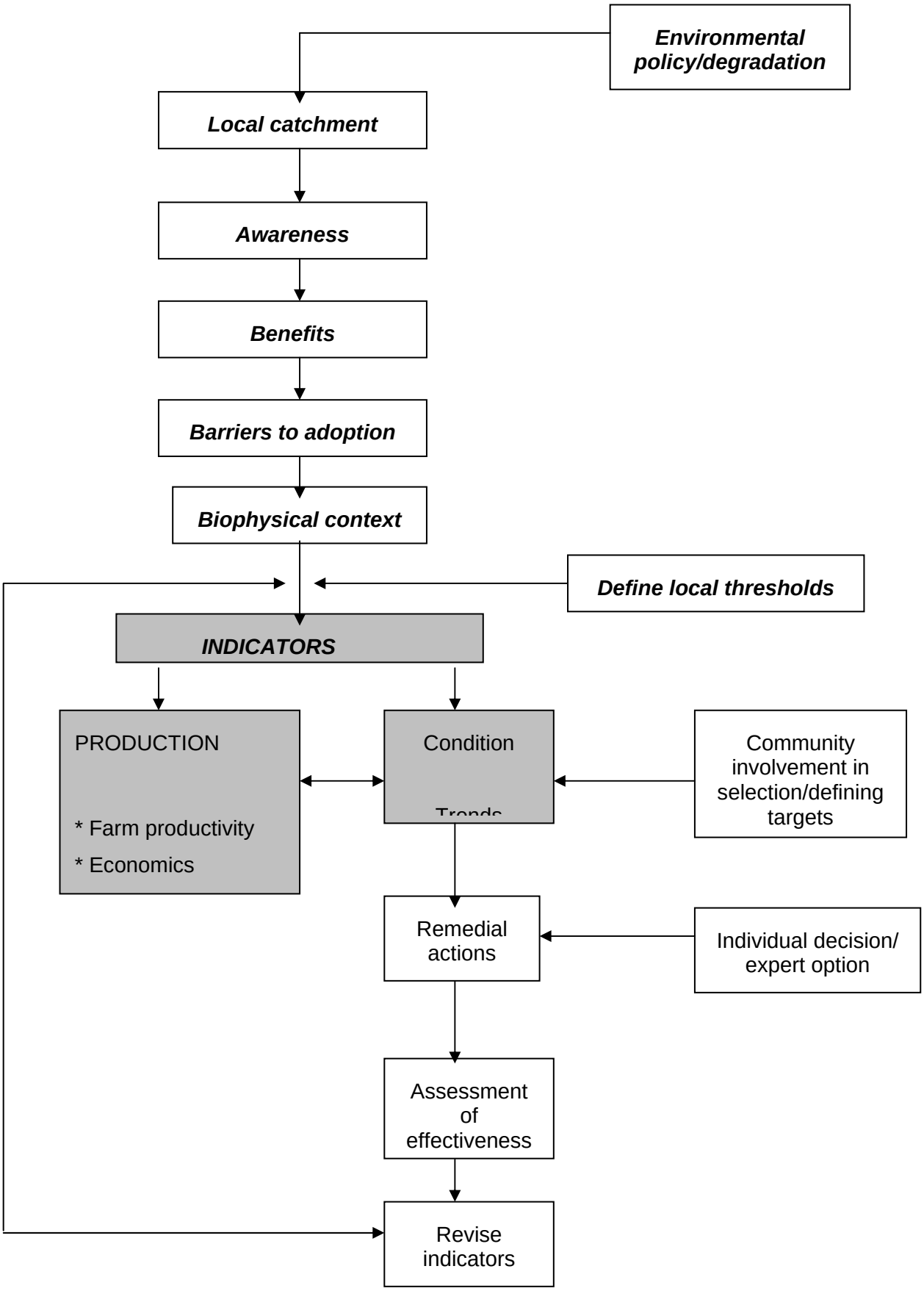


Table 4.c Proposed farm and catchment scale health indicators for Australian agro-eco systems

Condition	Trends	Farm productivity
Soil consistence	Bare soil	per cent potential yield
Soil texture	Root depth	DSE/ha/100 mm effective rainfall
Soil colour	Soil pH	Timber production (m^3/ha/year)
Plant water uptake rate	Soil EC	Grain protein concentration (per cent)
Soil strength	per cent weeds	Oil seed concentration (per cent)
Slaking and dispersal	Stream pH	Hauteur (mm) – wool
Cotton strip test	Stream EC	Milk quality (per cent butterfat, protein)
Total N	Turbidity	
Total P	Macro-invertebrates	
Exchangeable K	Watertable depth	
DTPA test		
Groundwater EC		
Tree cover %		

Note: Each farmer can select from the above list the indicators that are relevant to their farm. A few relevant and regularly collected indicators are more important than many irrelevant ones.

Table 4.d The Trend Report Card

This table shows the trend over 5 years for paddocks with annual pastures, perennial pastures and for the total farm.

Trends: Annual pastures

Indicator		Very good	Good	Fair	Poor	Very poor
Bare soil	1				→	
Root depth	2				→	
Soil pH	3			→		
Soil EC	4		←			
Weeds	5					→
Stream pH	6		→			
Stream EC	7				→	
Turbidity	8		←			
Macro-invertebrates	9					←
Water table depth	10				←	

Overall
↓

Trends: Perennial pastures

Indicator		Very	Good	Fair	Poor	Very
Bare soil	1			←		
Root depth	2		←			
Soil pH	3		→			
Soil EC	4		←			
Weeds	5		←			
Stream pH	6		→			
Stream EC	7				→	
Turbidity	8		←			
Macro-invertebrates	9					←
Water table depth	10		←	———		

Overall
↑

Farm productivity and product quality (wheat/Lucerne pastures/canola)

Indicator	Excellent	Good	Fair	Poor	Overall trend
% potential crop yield		←			
DSE/ha/100mm rain		←			↑
Grain protein			→		
Oilseed concentration		→			
Hauteur		←			

The SCARM in addition to identifying five principles of sustainability (see earlier) also identified five key indicators of sustainable agriculture. Each of these indicators is then expanded to describe the attributes needing examination for each of these indicators.

These broad indicators and attributes are relevant to farm systems throughout Australia – see Tables 4.e and 4.f. They do not however deal with regional differences, nor do they provide detailed direction to a farm manager who seeks to establish and maintain a sustainable farm system.

These indicators do however represent a national (as distinct from a regional) approach to the assessment of the condition of Australia's natural resources. It is desirable that regionally specific indicators be taken into account when assessing farm condition.

A recent publication by Walker et al[19] can assist farmers in assessing the condition of the catchment in which they are located.

In this book the SCARM indicators will be used together with Walker and Reuter's report card concept to measure sustainability. Another complementary system has been developed by the Victorian Farmers Federation, details of which appear in Appendix 1.

[19] Walker J., Veitch S., Dowling T., Braaten R., Guppy L. and Herron N. "Assessment of Catchment Condition", CSIRO Land and Water, June 2002.

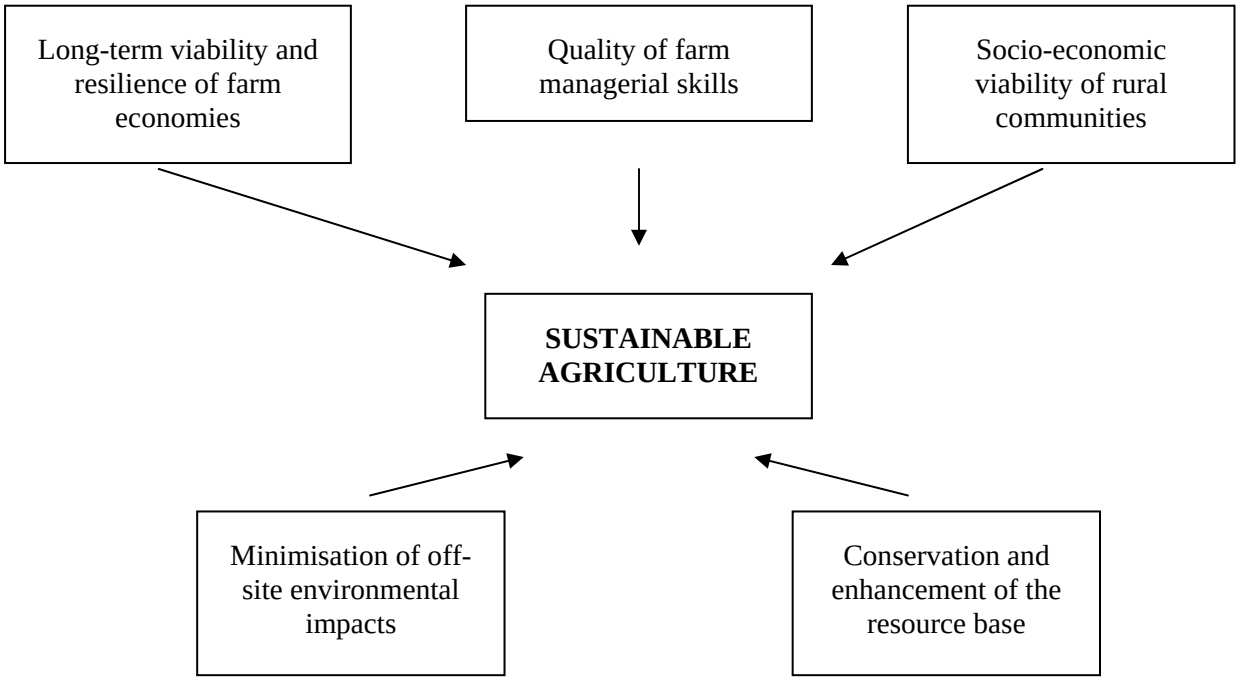
Table 4.e The indicators for Sustainable Agriculture

Indicators and attributes as examined by the National Collaborative Project on indicators (SCARM indicators)

Indicator (Issue)*	Attributes (or measurable indicator)*
Long-term Real Net Farm Income	Real net farm income
	Total factor productivity
	Farmers' terms of trade
	Average real net farm income
	Debt servicing ratio
Natural Resource Condition	Nutrient balance: P and K
	Soil condition: acidity and sodicity
	Rangeland condition and trend
	Agricultural plant species diversity
	Water utilisation by vegetation
Off-site Environmental Impacts	Chemical residues in products
	Salinity in streams
	Dust storm index
	Impact of agriculture on native vegetation
Managerial Skills	Level of farmer education
	Extent of participation in training and Landcare
	Implementation of sustainable practices
Socio-Economic Impacts	Age structure of the agricultural workforce
	Access to key services

Author's note: SCARM uses the term indicators in a different way to many others. When comparing SCARM's work with others it is helpful to call their indicators "Issues" and their attributes "Measurable Indicators".

Table 4.f Basic components of sustainable agriculture



4.4 Steps in applying sustainability to farm systems

In order to apply sustainability principles to the current condition of an existing farm system it is important to develop a logical process. When the process is identified and important criteria selected then a means of measuring these key criteria also needs to be established.

In the previous section we noted that SCARM had identified five indicators and many attributes which were important on all Australian farms. It is proposed that the **SCARM model** together with **"trend report card" approach provided by Walker** are used as a basis for developing a system of indicators and reports for any selected farm.

The methods by which each of these attributes are to be measured also needs to be identified. The technical issue of measurement is a large one and beyond the scope of this book. It is however an important and necessary activity for land managers[20]. It is also necessary to relate the current measurement for each attribute to the report card. This involves evaluating the existing measurement and rating it using Walker's grading of Very Poor, Poor, Fair, Good and Very Good. This task may be easy to complete or may involve extensive consultation with local scientists and farmers. The publication "Assessment of Catchment Conditions" by Walker et all assesses nearly all Australian agricultural areas for **water**, **land** and **biota** and may be used as a guide to the ratings.

The SCARM indicators and attributes need to be adjusted to reflect the issues important to any specific farm and the catchment in which it is located. This process is set out in section 4.4.1.

[20] For more information refer:
"Indicators of Catchment Health", CSIRO,
"Land Manager's Monitoring Guide", Queensland Department of Environment and Resource Management

4.4.1 The process of evaluating farm systems for sustainability

Tasks to be performed: Steps 1 - 6

- **Step 1 Identify a credible model of indicators and attributes.**
- **Step 2 Analyse the model.**

  This involves analysing the **indicators** and **attributes** to determine whether they cover all of the key issues for any particular farm system. This process is likely to involve local agricultural scientists with excellent knowledge of issues in the area.

- **Step 3 Revise the model.**

  The key attributes relevant to the selected farm and catchment are identified.

- **Step 4 Identify the importance and frequency of measurement of each attribute.**

  Classify each of the attributes in terms of their perceived importance using a scale:

  - H High importance
  - M Medium importance
  - L Low importance

  Regularly measure the key attributes. A means of measuring these attributes needs also to be identified together with a program which specifies the frequency of measurement and the benchmarks towards which the farm system is aimed.

- **Step 5 Prepare a report card showing trends in the condition of the key attributes.**

  This involves an assessment of the current measurement of each attribute and rating it from Very Poor to Very Good.

- **Step 6 Establish a management system for continuous improvement and refinement.**

4.4.2 Applying the process on the case study farm

The process described in the previous section now needs to be applied and adopted to a particular farm.

The case study on "Fairview" will be used to illustrate how this might be accomplished.

(See Table 4.g to view the completed report card.)

The case study provides the information which is traditionally provided in a farm plan and budget, together with specific ways of increasing the profitability of the business by leasing. This plan can now be analysed to determine the extent to which sustainability and profitability are being taken into account, using the process described in the previous section.

Each of the steps set out in the previous section will now be applied to the case-study farm.

- **Step 1 Identify the model to be used**

  The SCARM model described in Table 4.e is now used to evaluate "Fairview". The **indicators** will be adopted in their present form however the **attributes** need modification, both to relate more closely to farm management practises on "Fairview" and to meet the needs of the case study farm. The attributes chosen are shown in Steps 3 and 4 of the 'Tasks to be performed', where their importance and frequency of measurement are also described.

- **Step 2 Analyse the model**

  These indicators and attributes were developed in order to identify national and regional trends in sustainability.

  It is important that each farm relates its own performance to national criteria of this type. Hence the indicators do not need to be changed; however the attributes need changing to place a greater focus on individual farm and catchment performance relative to the industry in which it operates. This model will now be revised, and each attribute classified in terms of frequency of measurement and importance. Steps 3 and 4 will be undertaken concurrently.

- **Step 3 REVISE the model**

  Identify key attributes relevant to farm and the catchment in which it is located.

- **Step 4 Identify the frequency and importance of the attributes and a means of measuring them.**

  From the attributes discussed in the SCARM model farmers need to be aware of the declining terms of trade which is reported as being –1.7% p.a. on average over the period from 1980 to 1996. Producers need to be aware of the increase in productivity needed to offset this decline and have a plan to counter it. However the following financial criteria are recommended for use to replace the SCARM attributes. The methodology used is the one used by ABARE in its annual survey and is widely recognised and used throughout Australia.

Indicators and revised attributes for "Fairview"

Indicator 1 Long-term real net farm income

Revised attributes

Attribute	Importance	Frequency of Measurement
Farm cash income compared against average farm cash income of the industry group as reported in the Annual ABARE survey	High	Annually
Farm business profit compared against average farm business profit of the industry group as reported in the Annual ABARE survey	High	Annually
Farm debt at 1/7 compared against average farm debt at 1/7 of the industry group as reported in the Annual ABARE survey	Medium	Annually
Equity % compared against average equity % of the industry group as reported in the Annual ABARE survey	Medium	Annually
Rate of return compared against average rate of return of the industry group as reported in the Annual ABARE survey	High	Annually
Debt servicing ratio compared against average debt servicing ratio of the industry group as reported in the Annual ABARE survey	High	Annually

The following **indicators** and attributes are largely accepted in their original SCARM form, however the frequency of measurement and importance are also identified. Refer back to Table 4.5 to compare the attributes selected below for Fairview, with the SCARM attributes.

Indicator 2 Natural resource condition

Attribute	Importance	Frequency of Measurement
Nutrient balance P K	High	1/3rd property each year
Soil acidity and sodicity – especially along drainage lines	High	Each soil type annually
Conservation areas – remnant vegetation and established plantations – condition and trends	High	Annually
Agricultural species diversity	High	2-3 year intervals
Water utilisation	High	Annually

Note: "Rangeland condition" is not included above for Fairview but is an attribute identified by SCARM.

Indicator 3 Off-site impacts

Attribute	Importance	Frequency of measurement
Chemical residue in products	High	Annually
Salinity in streams	High	At peak and low stream flows
Impact of the farm on native vegetation	Medium	Periodically

Note: "Dust storm index" is not included above for Fairview but is an attribute identified by SCARM.

Indicator 4 Managerial skills

Attribute	**Importance**	**Frequency of measurement**
Level of farmer education	High	Annually
Participation in training to develop a sustainable and profitable system	High	Annually
Implementation of sustainable practises	High	Annually

Indicator 5 Socio Economic Impacts

Attribute	**Importance**	**Frequency of measurement**
Age structure of the workforce	High	Annually
Access to key services	High	Annually

Now that key indicators and attributes have been identified each farm business needs to review its measurement and reporting process and prepare a report card to ensure that all aspects of sustainability are integral to managerial activity.

- **Step 5 Preparing a report card showing trends in condition**

  The methodology identified in this section will now be adapted for the case study farm, see Table 4.8.

  Each attribute is measured and given a rating from Very Poor, Poor, Fair, Good and Very Good based on Walker et al's book "Assessment of Catchment Condition". The trend in each attribute is also assessed to indicate if it is improving or declining. The trend can only be established once two or more measurements of each indicator have been taken.

  Some of the attributes may require several different measurements e.g. the chemical residue in produce. Hence it will be beneficial to attach the additional measurements to the report card.

Table 4.g Example report card on Fairview – The case study farm (See Chapter 9)

			Trends				
Indicator	**Attribute**	**Measurement based on forecast @ 30/6/10**	**Very good**	**Good**	**Fair**	**Poor**	**Very poor**
Long-term Net	Farm Cash Income	$146,000					
Overall trend ↕	Farm business profit	$66,000		•			
	Farm debt	$520,000			•		
	Equity	90%			•		
	Rate of return	2.3%		•			
Natural resource	Nutrient balance P:K	P 13ppm			←•		
Overall trend ↕	Soil acidity and sodicity	5.0 pH in				←•	
	Conservation area	8%			←•		
	Ag species diversity	-			←•		
Off site impact	Chemical residue	Nil	•				
Overall trend ↕	Salinity in streams	EC 1200				←•	
	Impact on native vegetation	-		←•			
Managerial skills	Farm education	Extensive			•		
Overall trend ↕	Participation in training	20 hrs pa		←•			
Socio-economic	Age structure	53 y.o.			•		
Overall trend ↕	Access to services	-			•		

Each farmer can prepare an annual report card summarising the condition of sustainability on farm. The trend (indicated by an arrow) can be rated when two or more measurements have been made that are consistent for the catchment.

The rating of the measurement of each attribute is as discussed earlier a complex issue and needs to be made relative to the condition of the catchment in which the farm is located.

- **Step 6 Establish a management process for continual improvement**

  The level of investment in the improvement process will be influenced by the extent of the problems facing the farm, the farmer's commitment to environmental issues and the cost/ benefit of the exercise.

  The adoption of Best Management Practice (BMP) is an important first step which can be extended to a formal Environmental Management System (EMS) if the market rewards can justify the investment.

4.5 Combining sustainability and profitability

The Jones's are like most farmers, they want their farm to be both profitable and sustainable. Below we present the budgets they prepared to evaluate the cost effectiveness of combating acid soils and introducing raised bed cropping.

Example Acid soils and wool growing

In the Fairview case study the managers have recently become aware of increasing acidity. The increasing acidity is the long-term result of many factors which include:

- Long-term application of superphosphate
- Clover dominant pastures which produce Nitrogen, and help leach the calcium from the soil surface
- Removal of deep rooted trees which help recycle nutrients

Currently many soil areas on the farm have a pH of 4.7 when measured in Calcium Chloride. Experiments have shown that the application of 2.5 t/ha of lime costing $40/t applied will lift the pH to 5.2. An optimum and desirable pH would be 6 or higher. To achieve a pH of 6 would probably involve the application of 6 t/ha costing $240/ha. The farm manager must decide whether to apply relatively regular amounts of lime – say every 7-10 years, or invest a larger amount initially and a lesser amount thereafter.

Once the costs of remedying problems and ensuring a sustainable system are identified, it is then useful to compare the costs and returns of the new system with the old system. And this is done below.

The Fairview soil scientist estimates 2.5 t/ha of lime needs to be applied every 7 years to maintain a healthy soil pH then the annual cost can be estimated as follows:

Table 4.a Annual Cost of Lime

Cost 2.5 t/ha x $40/t applied		$100
Annual cost @ 8% interest and 7 year life		$100 x 0.1921
	=	**$19.21 pa**

This cost can be compared with extra returns. If the current gross margin/DSE for wool sheep is $18 then the extra sheep needed to pay for the lime is as follows:

Annual cost of lime	=	$19.21 pa
GM/DSE	=	$25.00
No of sheep to break even	=	0.77 sheep/ha

At Fairview they estimate the stocking rate would be raised by 2 DSE/ha, so the above applications are profitable.

Example 4.2 Raised beds

This example looks at the use of raised beds on land which is gently sloping, and on which crops suffer as a result of heavy soils and water-logging.

Please note this example considers only one key issue on the farm. It assumes that other sustainability issues have been addressed. It also involves costing a relatively new technique – the long-term effects of which are as yet unclear.

Capital cost	**Cost/ha**
Contractor cost to set up raised beds, including surveying	$300
Application of lime to correct excess acidity – 2t/ha @ $40/t applied	$ 80
TOTAL capital cost	**$380**

Annual cost	
Amortisation of bed costs assuming a 10 year write off and 8% interest = $380 x 0.149	$56.62
Reshape beds $60/ha every 3 years	$20
TOTAL annual cost	**$76.62**

This extra cost can then be viewed against extra income generated from the cropping operation.

This methodology can be used in many different situations which involve an initial capital outlay and ongoing extra costs. The key issues are establishing the key parameters on which the costing is based.

If for example the beds only lasted 5 years then the amortised cost of capital would be $380/ha x 0.2505 = $95.19 + $20.00 = $115.19/ha. This is $38.57/ha more than when the capital cost is written off over 10 years. The cost of these new systems must be seen as a part of the whole farm system and hence we need new systems to help achieve them.

4.6 Marketing sustainability

The broad definition of sustainability used in this chapter ensures that natural resources both on and off the farm are managed in an environmentally sustainable manner. Hence any landowner who adopts the report card approach is adopting an Environmental Management System (EMS).

The key marketing issue for a farmer with an EMS is whether a return can be obtained from the sale of products produced in an environmentally friendly manner. This is a complex issue and it is currently the subject of extensive debate in many government, retailer and producer sectors.

We then make the following observations on marketing an EMS:

- Consumers are increasingly concerned about the environment, and hence governments are developing policies which will lead to increased use of EMS.
- Most consumers are more concerned by their own health and the quality of products rather than by the eco-friendly means by which products are produced.
- Large retailers are increasingly interested in eco-certification and labelling but will rarely pay a premium for eco-friendly production systems.
- Because consumer concerns for the environment are increasing it is desirable for farmers to anticipate the need for EMS.

Hence we believe that farmers are well advised to identify a system of sustainability – identify its cost and benefits and be prepared to implement it. It is better to be prepared and proactive than to have regulations imposed from outside. Farmer lobby groups need to provide a strong message to the community that the cost of EMS should be borne by all consumers' not just farmers.

Part 2: Leasing in Australia in practice

This section focuses on the economic, legal and management issues associated with setting up and managing a successful land lease in Australia.

5 Farm business performance and land values

This chapter provides an overview of the financial performance of broadacre farms in Australia. The tables and graphs have been sourced from "Australian Farm Survey Results 2007/08 to 2009/10" by ABARE, April 2010.

5.1 Major farm financial performance indicators

ABARE surveys use the following definitions to compile their data:

- Farm cash income = total cash receipts (total revenues received by the farm business during the financial year) - total cash costs (payments made by the farm business for materials and services and for permanent and casual hired labour (excluding owner manager, partner and family labour)).
- Farm business profit = farm cash income + changes in trading stock – depreciation – imputed labour costs
- Profit at full equity = farm business profit + rent + interest and finance lease payments – depreciation on leased items (return produced by all the resources used in the farm business)
- Rate of return = profit at full equity ÷ total opening capital x 100 (return to all capital used)
- Off-farm income = wages off-farm + other business income + investment + social welfare payments (owner manager and spouse only).

Farm cash income

A key measure of farm business viability is Farm Cash Income. Table 5.a identifies farm cash income for all Australian broad-acre farms from 2007-2011; and also followed by data on other key farm business performance indicators.

Table 5.a Farm cash income: financial performance, all broadacre industries

Average per farm		2007-08	2008-09 (s)		2009-10 (z)
Total cash receipts	$	338,650	336,600	(4)	311,000
Total cash costs	$	274,430	260,700	(3)	250,000
Farm cash income	$	64,220	76,000	(6)	62,000
Farms with negative farm cash income	%	34	29	(6)	29
Farm business profit	$	(11,310)	(1,500)	(288)	(18,000)
Farms with negative farm business profit	%	68	68	(2)	70
Profit at full equity					
– excl. cap. Appreciation	$	29,380	36,600	(12)	18,000
– incl. cap. Appreciation	$	84,360	40,600	(29)	na
Farm capital at 30 June (a)	$	3,898,150	3,800,300	(2)	na
Net capital additions	$	40,110	43,500	(22)	na
Farm debt at 30 June b	$	413,060	409,000	(5)	418,000
Change in debt -1 July to 30 June (b)	%	8	4	(43)	4
Equity at 30 June (b)(c)	$	3,362,320	3,234,200	(3)	na
Equity ratio (b)(d)	%	89	89	(1)	na
Harvest loans at 30 June (e)	$	5,870	2,200	(30)	na
Farm liquid assets at 30 June (b)	$	142,710	153,300	(8)	na
Farm management deposits (FMDs) at 30 June (b)	$	28,160	28,800	(9)	na
Share of farms with FMDs at 30 June (b)	%	22	22	(7)	na
Rate of return (g)					
– excl. cap. Appreciation	%	0.8	1.0	(12)	0.5
– incl. cap. Appreciation	%	2.2	1.1	(29)	na
Off-farm income of owner manager and spouse	$	34,030	35,800	(5)	na

a Excludes leased plant and equipment.
b Average per responding farm.
c Farm capital minus farm debt.
d Equity expressed as a percentage of farm capital.
e Harvest loans are not included in farm debt.
g Rate of return to farm capital at 1 July.
s Preliminary estimate.
z Provisional projection.
na Not available.

Note: Figures in parentheses are standard errors expressed as a percentage of the estimate provided.

The average farm cash income from all broadacre farms was $64,220 for 2007/08, $76,000 in 2008/09 and $62,000 in 2009/10.The rate of return including capital appreciation is low at around 2%.

Table 5.b identifies farm cash income over the period from 1991 to 2010.

Table 5.b Financial performance (all broadacre industries)[21]

Average per farm

Over the 20 year period from 1991 to 2010, farm cash income was highly variable: It varied between $40,000 to $120,000; whilst farm business profit ranged from a loss of $70,000 to a profit of $50,000.

Table 5.c Financial performance of broadacre farms, by industry[22]

Average per farm

	Farm Cash Income $			Farm Business Profit $ a		
	2007/08	**2008/09**	**2009/10**	**2007/08**	**2008/09 s**	**2009/10**
Wheat and other crops	115,440	175,800	132,000	2,390	52,000	3,000
Mixed livestock crops	79,730	74,700	65,000	-10,880	-4,900	-25,000
Beef industry	40,090	48,400	26,000	-15,490	-13,700	-33,000
Sheep	56,860	42,800	57,000	-13,670	-22,900	-2,000
Sheep beef	35,050	60,900	64,000	-20,280	-5,100	-8,000
All broadacre industries	64,220	76,000	62,000	-11,310	-1,500	-18,000
Dairy	129,310	88,000	50,000	65,830	6,700	-44,000

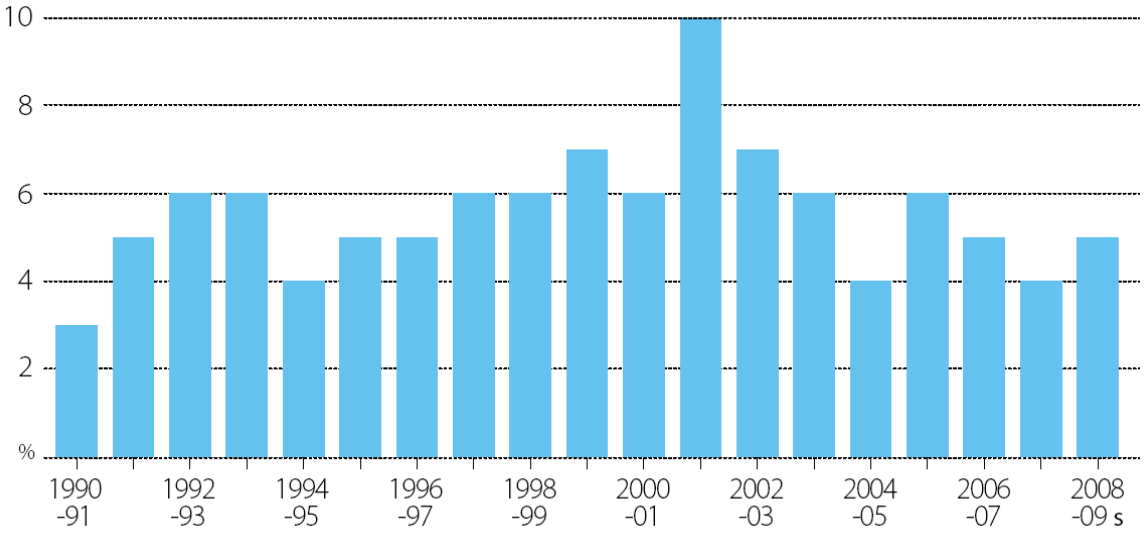
For the three year period from 2007 to 2010 "wheat and other crop" farms generated the highest farm cash income of $115,440 to $175,800, followed by dairying of $50,000 to $129,310, then mixed crops, with beef producers the lowest at $26,000 to $40,090.

[21] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra
[22] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra

Table 5.d Debt servicing ratio, broadacre and dairy farms[23]

The proportion of farm cash income needed to meet interest payments ranged between 12% to 52% from 1991 to 2010, and has trended upwards in recent years.

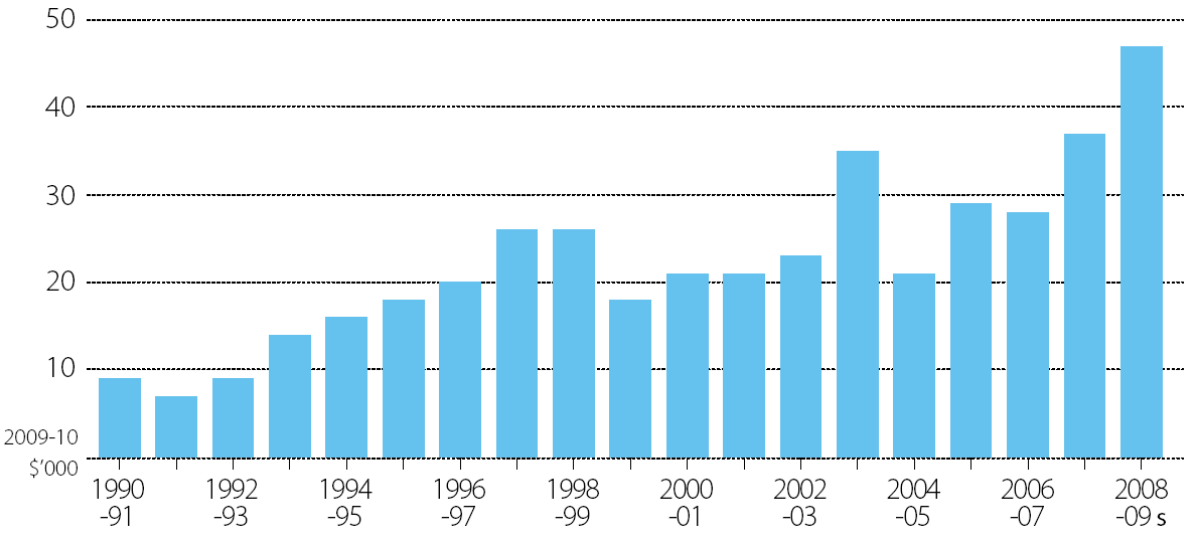
Table 5.e Proportion of farms acquiring land, broadacre and dairy farms[24]



The proportion of farms acquiring land has ranged between 3% to 10% over the period 1990 to 2009; averaging 6%.

[23] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra
[24] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra

Table 5.f Additions of non-land capital, broadacre and dairy industries[25]



The additional non-land or working capital invested by farms has trended upwards from 1990 to 2009.

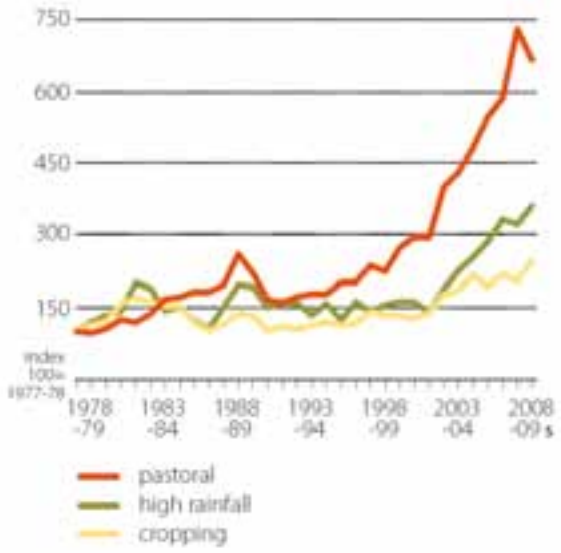
Table 5.g Farm cash income, broadacre farms[26]

Average per farm

The farm income generated by farms for the period 1993 to 2009 has ranged between $110,000 to $305,000 for the top 25% of farms; $20,000 to $100,000 for the middle 50%; and $0 to a loss of $50,000 for the bottom 25%.

[25] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09*, Canberra
[26] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09*, Canberra

Table 5.h Land prices for broadacre farms[27]



From 1978 to 2000 land prices showed a small upward trend with a notable rise and fall from 1988 to 1991.

From 2000 to 2008 land prices have risen dramatically, especially in the pastoral sector.

Table 5.i Land prices and receipts per hectare, broadacre farms[28]

Whilst land prices rose markedly from 2000 to 2009, receipts per hectare have only risen slightly (Note – the table shows the annual change relative to an index).

[27] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra
[28] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra

5.2 Conclusions - farm business performance and land values

- In Australia there are many small farms which do not provide adequate living for the operators. Many of these land owners would be better off financially if they leased their land to other larger farmers.
- To run a viable, profitable and sustainable farm business has been a very difficult task in all but the last two years of the past decade for 75% of all farmers.
- The returns from farming are extremely volatile even in areas which have relatively little climatic risk such as south western Victoria.
- Since 2000, land values have risen rapidly above the long-term trend line. This has reduced the productivity of farm land in relation to its value.

6. The economics of land leasing

This chapter considers the economic principles and practices of land leasing to assist the reader to value and manage rural land leases in a sustainable manner.

6.1 Economic principles & risk

The economics of land leasing are relatively simple. The inputs into a farm system land, labour, machinery, stock, and working capital are divided between the landowner and tenant farmer. The landowner provides the land and usually minimal or no labour and machinery, whilst the tenant provides the labour, machinery, stock and working capital. In return the landowner receives the rent whilst the tenant receives the farm profits or losses, thereby accepting the risk.

Table 6.a Economic inputs and returns from a rural lease

Inputs	Landowner	Tenant
Land	✓	-
Labour	-	✓
Machinery	-	✓
Stock	-	✓
Working capital	-	✓

Returns	Landowner	Tenant
Rent	✓	-
Land value change	✓	-
Farm profits / losses	-	✓

In circumstances where the land needs capital improvement the tenant may agree to the landowner entering onto the land to effect such improvements or the tenant may install improvements in lieu of rent. However in most standard leases where no capital improvements are needed the landowner bears minimal costs other than rates and insurance (on structures and public liability).

The **capital** required by the **tenant** in order to conduct the lease can vary dramatically. A **cropping lease** may be conducted by a tenant who has sufficient machinery to manage the extra lease area. In such a case the cost of conducting the lease will bear minimal overhead costs for machinery, which will keep lease costs low.

This contrast markedly with the situation where extra machinery has to be purchased to conduct the lease or a contractor is employed to sow and spray the crop. These situations will increase the costs of conducting the lease and make these tenants less competitive if bidding for a lease.

For a grazing lease a similar principle applies. The tenant may be able to stock the tenancy from existing stock on hand or they may have to borrow and buy stock. This scenario will mean they incur interest expense and risk a fall in the value of the stock at the end of the lease.

Each situation needs to identify clearly the capital involved and its associated costs. A key principle that is relevant to all leasing and share-farming agreements is that prior to the lease commencing a thorough analysis of all of the costs and returns need to be identified and taken into account in determining what is fair. The risks and returns involved in a lease are now considered for a traditional and participatory lease.

6.2 Traditional versus participatory leases

The traditional lease model

Landowner – returns (see Table 6.b)

The landowner's return is the rent and any capital gain on the land. The rent return is fixed by the lease agreement and is frequently 3-6% of the broadacre land value. The capital gain depends on increases in land values generally and is discussed later in this chapter. The rent should be expressed in terms of the **effective area** of the land.

Table 6.b A lease example – land used for cropping

Example – A 1,100 ha farm leased for $200,000 pa has an effective area of 1,000 ha and is leased for $200 / ha **effective***.

Landowner's Returns and Costs		**$'000**	**$'000**
Land Value		4,000	1,600
(landowner's capital)		**Per ha.**	**Per acre**
Income			
Rent	**(a)**	*$200/ha*	*$80/acre*
Costs			
Rates and insurance		12	
Repairs to structures**		6	
General overheads		4	
Interest on land loans ($150,000 x 8%)		12	
Total costs	**(b)**	**34**	**13.6**
Net Income	**(a-b)**	**166**	**66.4**

Gross return as% of land	=	**$200** / **$4,000**	**x**	**100** / **1**	=	**5.00%**

Net income before interest as% of land value	=	**$166 + $12** / **$4,000**	**x**	**100** / **1**	=	**4.45%**

***The effective area of the farm was determined after an accurate map of the farm was prepared by an independent mapping specialist.

****It is desirable that the landowner re-invest sufficient of the rental income to maintain farm assets. This could frequently be 10% of the gross rent depending on the condition of the farm when the lease commences.

Landowner - costs (see tables 6.c & 6.d)

The costs for the landowner are usually rates, insurance, interest on loans, and any overheads associated with the land including repairs which are legitimately the landowner's costs; and administration costs such as accounting fees and telephone expenses.

The return to the landowner is the rent and any capital gain made as a result of any increase in land value. The capital gain will vary depending on the location of the land and its proximity to population and services. Ideal capital growth would be at or above inflation rates. Currently, inflation is around 3% per annum; hence a long-term capital gain of 4% per annum is desirable. When this return is added to the net income (see Table 6.b) an overall return of 8 to 9% per annum over the long-term is desirable (made up of 4 to 5% net income per annum plus a 4% per annum capital gain).

Tenant – costs and returns (see tables 6.c & 6.d)

The costs and returns for the tenant arise from the farm enterprise being conducted. There is no capital gain to consider. The tenant takes the risks associated with seasons, prices and costs. Hence the return is much more volatile than that experienced by the landowner.

The tenant must provide the labour, machinery and working capital needed to run the enterprise. The tenant has sufficient machinery to crop the extra area without acquiring extra machinery. Using the same example as for the landowner the tenant's capital and returns are as follows:

Table 6.c A lease example – continued – land used for cropping

A 1,000 ha farm leased for $200,000 pa or $200/ha		
Tenant's capital – assuming the land is cropped		**Notes**
Machinery capital	$300/ha	
Working capital	$275/ha	$350/ha direct crop costs + $200/ha overhead costs + $200/ha lease = $750/ha
Total capital (tenants)	**$575/ha**	Average capital = $550/ha ÷ 2
Income & Costs		
Income	**$/ha**	
Average crop gross margin	**400**	(Gross return $750 (3t x $250/t) on farm less direct costs $350/ha = Gross Margin $400)
Rent	200	
Overhead Costs	22	$375 @ 8% average working capital
- Labour	20	
- Insurance	4	
Travel and sundry	4	
Total Costs	**250**	Before managerial allowance
Net Cash Income	**150**	
Managerial allowance	**20**	
Net Cash Income	**122**	

Notes:

- The total extra capital needed to operate the lease is $550/ha. x 1,000ha. = $550,000. The tenant must ensure that they can fund this extra capital.
- An example for a stock lease is provided in Section 5.6.6.

Risk

The returns from farming are extremely variable; consequently a tenant needs to make a thorough assessment of the likely range of returns arising from a lease as set out in Table 6.d.

Table 6.d A lease example – continued – land used for cropping - cash income

Land = 1,000 hectares (see Table 6.b)

	Return on Capital		Farm Cash Income
Average Year	$= \frac{\$130/ha \times 100}{575} =$	22.6%	$130,000
Very Good Year	$= \frac{\$350/ha \times 100}{575} =$	66%	$372,000 *(based on 4t yield @ $250/t)*
Poor Year	$= \frac{-\$233 \times 100}{575} =$	-40.5%	-$233,000 *(based on 1.5t yield)*

This cash income is available for machinery replacement and as a reward for risk and management. The returns to the tenant are excellent when a good year and good prices are experienced but produce a loss if poor yields result. A tenant needs to assess their capacity to fund any losses that might arise – either from farm profits or increased debt.

Hence a prudent tenant not only needs increased working capital but increased reserves in order to be capable of funding a loss year. Cash reserves in the form of Farm Management Deposits are a tax effective form of maintaining reserve working capital. The tenant carries most of the risk of the operation but also receives most of the rewards if a good result is achieved.

The participatory lease model

(See Tables 6.e & 6.f)

In the traditional model just described the landowner makes a gross return of 5.0%, whilst the tenant makes a return of 22.6% in an average year, 66% in a very good year and a (40.5%) loss in a poor year.

The tenant is usually reluctant to pay rent in excess of 5.0% of land value because of the risk of experiencing a poor year in the first year of the lease. The relatively low rent return to the landowner contributes to the low supply of land made available for rent. If a higher rent was paid more rented land is likely to become available.

An alternate model to the one described could be considered. In the UK an increasing number of rental agreements are combining the economic features of leasing and share-farming. These are called **participatory tenancies**. The tenancies are described below by Bob Hall who visited the UK in 2000:

Since returning from the UK Bob has continued to develop the applicability of this model to grazing situations in W.A. An example of how a participatory lease might apply in southern Australia is now provided:

A participatory lease by J.R.L. Hall

The system works as follows: the tenant supplies, stock, plant, labour as normal; the landlord supplies the land as normal. The two put in working capital for the variable costs. This is in equal proportion. There is a stakeholder, the manager or agent who holds the money, pays the accounts, does all the paperwork and receives the money, including subsidies in the UK. Subsidies take a lot of paperwork. For this he gets a fee of 5 to 12% of the turnover. Normally this is a shared cost. Sometimes the fee is paid, as traditionally, by the landlord as a% of his net return.

So there is output from an agreed farming program and variable costs again on a pre agreed basis both as a strategy (planned) and tactically as things develop, but always agreed prior to expenditure (a further task of the managing agent dealing with the tenant). This leaves a margin – very akin to a gross margin. The first call upon that margin is that the tenant gets paid for this work on a contract basis. The second call is for rental. After these two pre agreed costs, any surplus is split 50:50. If there is insufficient margin, then the landlord misses out on the rent, but that deficiency is made up by a first call on any future surplus.

Clearly everyone has to work in well and there is a very real task for the managing agent. He represents the landlord's interests and has to compromise continually with the tenant. He must be trusted and appreciated by both parties. No different than his normal task but very much more full on. The managing agent has a continual mediation/arbitration adjudication position. Typically a job well done has each party mildly unhappy, (or they have had a win!). The use of the agent or farm manager more properly described is to prevent warfare between the landlord and the tenant and it is a very important feature for relationships.

That all sounds great but the question is: What is the contract fee for the tenant and what is the rental for the landlord?

A profit sharing lease – option 1

Key assumptions:

- The landowner and tenant provide working capital in equal shares.
- The tenant has the first right to income to meet contracting fees of $70/ha for all contract expenses associated with preparing the land, sowing and managing the crop.
- The landowner has second right to income to meet a 4% return on land value i.e. $80/ha.
- Surplus in excess of these amounts is shared 50:50.
- If a loss results from this process it is borne by the landlord who has first claim against this loss in subsequent years.

Table 6.e A Barley crop – on leased land

	Poor	Average	Good

	Yield	2t		3t		4t
	@ $220/t on farm	**$**		**$**		**$**
Income		440		660		880
Variable costs	Seed, fert., spray, contract,	280		300		320
Gross margin / ha		160		360		560
Contract fee		80		80		80
Rent	4% land value	100		100		100
Total Rent and Contract		**180**		**180**		**180**
Margin available after rent and contract fee		**(20)**		**180**		**380**
Rent received by landlord	100 – 20 =	80	100 + 90 =	1900	100 + 190 =	290
Rent tenant receives		80	80 + 90 =	170	80 + 190 =	270
Total gross margin		**160**		**360**		**560**
Return on capital	Landlord $2500/ha	3.2 %		7.6 %		11.6 %
	Tenant $600/ha	13.3 %		28.3 %		45.0 %

Comments

- The landowner replaces a certain 5.5% with a probable 7.6% but also takes a risk, associated with the risk is a potentially higher return or lower return.
- The tenant is guaranteed a 13.2% return on capital in a poor year but reduces the return from an excellent year.
- The income sharing process described requires openness and honesty from both parties and an independent manager.
- If the landowner and tenant are not able to be open and honest with each other they may like to consider the following model.

A profit sharing lease – option 2

- The landowner has a right to a 4% return ($100/ha on land valued @ $2500/ha)
- If the gross margin is an agreed average one then the landowner receives an extra 2% - $50/ha extra = $150/ha in total ($100 + $50/ha)
- Any gross margin above the agreed average the landowner receives 15% thereof.

Table 6.f Using the Earlier Barley Example

	Poor	Average	Good
Crop gross margin	160	360	560
Landowner received	100	150	180
Tenant	60	210	380
Landowner Return to Capital ($2,500/ha)	**4%**	**6%**	**7.2%**
Tenant Return to Capital	**10%**	**35%**	**63%**

Comments on risk

Some risk sharing occurs:

- The landowner replaces a certain 5% for a 4 – 7% range
- The tenant receives a better return in a poor year and poorer return in a good year.

Other comments

- The options for risk and profit sharing are many. When profit sharing occurs there is a greater need for openness and the involvement of an independent manager who is properly paid for the job.
- If the landowner can obtain a higher return on capital it may encourage more land to be leased.

6.3 Methods for establishing a fair lease rate and term

A critically important issue of establishing a successful land lease is how much to pay for a lease and over what term. There are a range of methods for establishing a lease rate. We now consider these methods and identify which method is fair to both landowner and tenant, and is likely to result in a successful long-term lease agreement.

Valuation methods

The main methods used to value land leases are summarised below. When valuing a land lease it is important to consider all of these methods.

Table 6.g Types of land valuation

Lease valuation method	Common market rates	Usual conditions
1) Rate of return	• 3-6% of the current land value	• Landholder pays rates and insurance, and tenant pays all other costs
2) Rate per unit of production	• Stock: $10-20 / Dry Sheep Area / Year • Crop: high rainfall $100 / acre of area cropped	
3) A percentage of expected gross margin	• 50% of gross margin	

Each of these methods is now considered.

6.3.1 The rate of return method

This method is nearly always used by the landowner. The return from an investment in rural land is made up of the income and the capital gain. If land is bought for $3,000/ha and leased for $150/ha;

$$\textbf{The gross rate of return} = \frac{\$150}{\$3{,}000} \times \frac{100}{1} = 5\ \%$$

The landowner may expect say 6% pa in capital gain which provides an overall gross return of 5% + 6% = 11%.

A landowner who expects a high capital growth may be willing to accept a lower rent than one who expects a low capital gain.

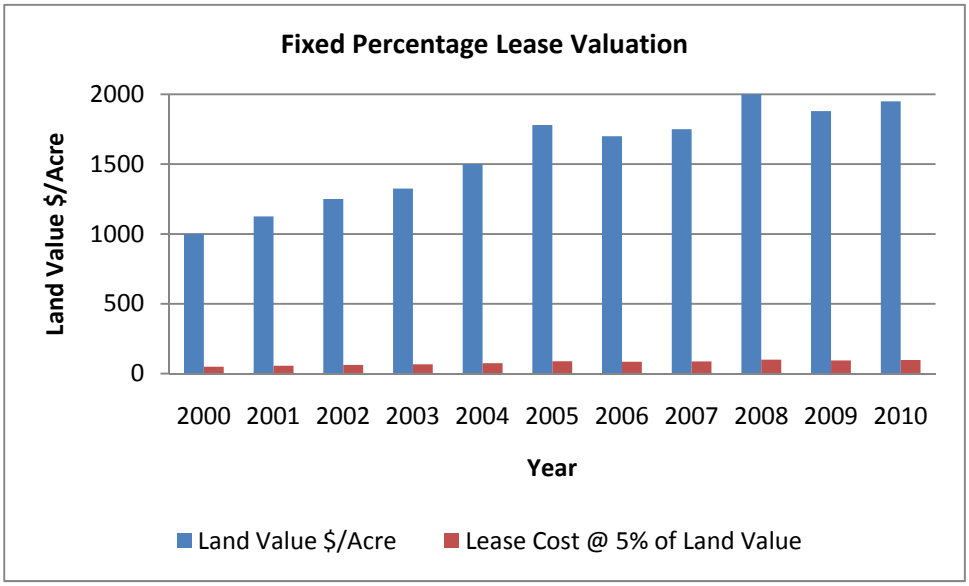
If the rent was determined by reference to a fixed percentage of land value then the lease cost would vary in-line with the land value as set out in Table 6.h.

Table 6.h Lease and land price

Example farm:

- Western Victoria – 40% crop / 60% grazing
- 600 mm annual rainfall
- Stock rate = 2.5 DSE per 100 mm rainfall

Land and lease value (5%)[29]



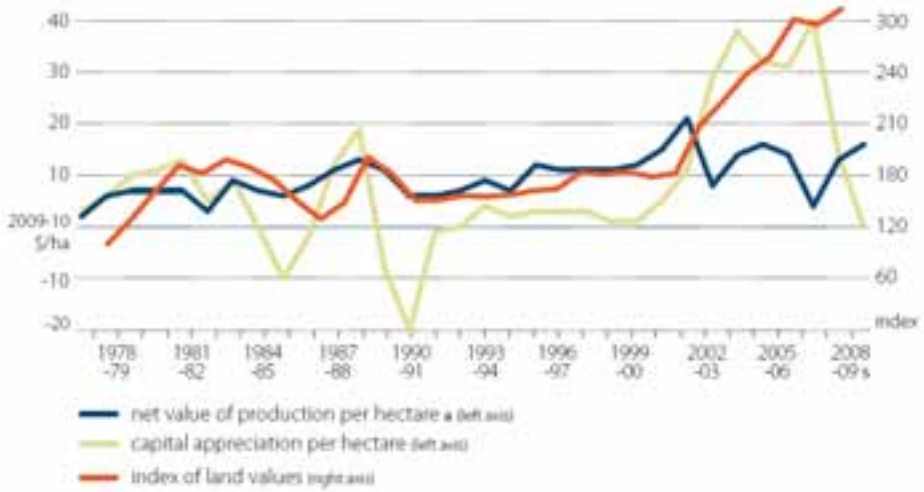
This method would be satisfactory if farm land values reflected farm income. This however has not been the case in recent years as discussed in chapter 5 (see Table 6.i & 6.j).

Table 6.i Land prices and receipts per hectare, broadacre farms[30]

Whilst land prices rose markedly from 2000 to 2008, receipts per hectare have only risen slightly (Note – the table shows the annual change relative to an index).

[29] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09*, Canberra
[30] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09*, Canberra

Table 6.j Land values and returns per hectare, broadacre and dairy industries[31]



(a) Net value of production is defined to be farm cash income at full equity plus the build-up in the value of trading stocks less government payments.

Tables 6.i & 6.j clearly show that through the 1980s and 1990s land values moved roughly in line with farm incomes. In the 2000s land values grew more quickly than they had previously.

There are many reasons for rapid increase in value which include:

- Record low interest rates,
- Rapid rises (or falls) in some commodity prices;
- Increased demand from more profitable farms;
- Optimism about future commodity prices as a result of prosperity in China and India;
- Growing urban populations;
- High rainfall land being used for cropping and increasing in value more than traditional lower rainfall crop land; and
- The demand from international investors.

The optimism of land buyers is frequently not reflected in farm returns which are subject to huge variations in production in addition to commodity price fluctuations. In recent years crop yields have been greatly affected by drought, frosts, water logging and heat stress, in addition to common problems with pests and rising fertiliser prices.

Conclusion on the rate of return method

It is appropriate and relevant to express a land lease as a percentage of the land's market value (which is often overstated).

This method alone however is NOT an appropriate means of determining a fair and sustainable lease rate. A landowner who will accept a low rental return on land value is usually anticipating a high capital gain, whilst a landowner who is not optimistic about capital usually expects a high rent return. Consequently landowner views about future capital gains will influence the rental value, even though the two are not directly related.

[31] ABARE 2009, *Australian Farm Survey Results 2006-07 to 2008-09,* Canberra

6.3.2 The rate per unit of production method

This method is used to relate the lease price to units of production with a view to comparing different lease rates. The method varies depending on whether the land is used for grazing or cropping, or both.

This method can be used to value an existing lease or evaluate a prospective lease.

An example best illustrates this method:

Table 6.k Mixed cropping and grazing lease example

Current Lease	450 ha	550 mm rainfall
	30 ha	Area of bush not used for agriculture
Effective area	**420 ha**	
Crop area	200 ha	
Pasture area	220 ha	Average pastures capable of running 10 DSE/ha
	420 ha	

Currently leased for $65,000 p.a. for 3 years, which represents:

$154.75 / ha effective = $\frac{\$65{,}000}{420 \text{ ha}}$ or $144.44 per ha = $\frac{\$65{,}000}{450 \text{ ha}}$

Valuation based on comparable leases:

Crop area	200 x $175/ha [32]	$35,000
Grazing area	220 ha x 10 = 2,200 x $15/DSE [33]	$33,000
Lease rate at comparable market rates		**$68,000**

This method is therefore useful for estimating the comparable market rate of land offered or subject to lease. It relies on having knowledge of comparable lease agreements. As lease prices are not published, access to this type of information is available from advisers with lease experience.

Benchmarking

It is desirable for benchmarks to be created to provide guidance on the suitability or lease rates. A register of leases would describe what was paid for land in relation to the land types, soil types, rainfall, and area. This is an area where Australia lacks an organised response and there is scope for academic and research initiatives to meet this challenge.

[32] The lease rates are based on the market rates paid for similar land.
[33] The lease rates are based on the market rates paid for similar land.

6.3.3 The percentage of expected gross margin method

This method is often used by the tenant. It first involves the calculation of the expected gross margin for the farm system to be conducted on the lease land. The estimated gross margin is the expected gross margins. Because a range of outcomes are likely, a range of outcomes and their estimated probabilities are prepared.

In order to establish a fair lease the expected gross margin is shared between landowner and tenant to determine whether a fair outcome is achieved. The lease period needs to be greater than 3 years so that a fair range of outcomes can be experienced. The gross margin needs to be prepared using contract rates for harvesting. If a tenant uses their own harvester then the contract rates are still used to ensure a fair return for the tenant.

Cropping example

We illustrate how this model is used for a cropping only property.

Table 6.l Lease price – cropping% of gross margin[34]*

- Gross Margins: Crop - wheat
- 600 mm annual rainfall long-term
- 500 mm annual rainfall expected
- Land value $5,000 / ha ($2,000 / acre)
- The tenant uses existing machinery for the crop operation

Return	**Low**	**Med**	**High**	
Tonnes / ha	2.5	3.5	5.5	
$ / tonne on farm	180	230	300	
Return / ha	**450**	**805**	**1,650**	
Direct Costs	350	400	450	
Contract harvest & before machinery OH				
GM / ha	**100**	**405**	**1,200**	
Rent @ 50% of GM	$50	$202.5	$600	
Rent @ % of land value	1%	4%	12%	**Total**
Probability (P)	10%	80%	10%	100%
Rent (P x (GM/Ha.))	10	324	120	454
50 % share				$227 ($90.80)/ac.(******)
Land owner RTC				4.54 % ($227/$5000) x (100/1)

*This gross margin can be compared with the SWFM project Wheat - $433 / ha in 2008/09 (3.1t / ha)[35].

****** Rate of Return for tenant = ($227/$575) = 39.4%

If the tenant was not able to use existing machinery and had to use contractors to sow and spray the crop, the rental value would fall.

Expected GM/ha. = $454/ha. – Contract Costs ($70) = **revised GM $384/ha.**

[34] *South West Farm Monitor Project 2008/09*
[35] *South West Farm Monitor Project 2008/09*

50% Share = $192/ha. for rent

Tenant – cropping rate of return = $192/$275 + $70 (instead of $300)
= $192/$345
= 55.6%

Landowners return **= $192/$5,000**
= 3.84%

Using a Contractor provides a higher return on Capital but a lower return per hectare. The lease may not be competitive as a result, as the landowner is unlikely to accept a 3.84% return.

Grazing example

We now illustrate this same method for a grazing property based on actual gross margins from the South West Farm Monitor Project.

Table 6.m Lease price – grazing% of gross margin[36]

Enterprise	Wool Sheep		Prime Lambs		Beef Cattle	
	AVG	Top 20%	AVG	Top 20%	AVG	Top 20%
Gross Margin / DSE	$12	$22	$18	$30	$20	$35
SR DSE / ha	15.6	14.8	16.1	13.5	15	19.3
GM / ha	$187	$326	$290	$405	$300	$675
50% of $ / ha	$94	$163	$145	$203	$150	$338
50% of $ / DSE	$6	$11	$9	$15	$10	$17.50

Clearly the enterprises with the highest gross margin can afford to pay more for rent. The South West Farm Monitor Project rates can be compared with the market rates paid in the region (see Table 6.n).

Table 6.n Lease prices in the region

Market rate	$ / ac	$ / ha	DSE / ha	$ / DSE
Low	$60	$150	15	$10
Med	$90	$225	15	$15
High	$120	$300	15	$20

The grazing lease involves the capital needed to buy stock which is currently at an all time high level. The effect of high stock values is considered in Section 6.5.

6.3.4 Choosing a method and term

In order to understand fully the financial implications of a lease it is ideal to use all three methods of valuation set out in this section. In this way, the likely returns for landowners and tenants are clearly identified, and a comparison made with comparable market rates.

A long-term lease is most frequently desirable from a tenant's perspective; however the landowner is unlikely to enter into a long-term lease if they do not feel that the lease agreement is fair to both parties.

[36] *South West Farm Monitor Project 2008/09*

A short-term lease of 1 – 3 years is rarely long enough for the tenant to experience a range of outcomes. An ideal lease would be 3 x 3 years. Such a lease would provide the tenant with a **right of renewal**, the terms of which need to be established at least 6 months before the end of the term.

6.4 Leasing versus share farming

There are two main forms of share farming agreement; 50:50 and 75:25, and many variations. In the 50:50 agreement the landowner and tenant share costs and returns, whilst in the 75:25 agreement the tenant pays all costs and receives 75% of returns, and the landowner accepts 25% of returns. Table 6.o illustrates the likely range of returns associated with these methods.

Table 6.o Share farming example - cropping

Gross Margin $ / ha			**$100**	**$405**	**$1,200**
Type of Agreement	**Share of Income**		**Low**	**Med**	**High**
50 / 50	Share-Farmer (SF) income		$50	$202.50	$600
	Landowner income		$50	$202.50	$600
75 / 25	SF – Income	(75%)	$338	$604	$1,238
	SF – Costs		$350	$400	$450
	SF – Return		($12)	$204	$788
	Landowner	(25%)	$112.50	$201	$412

The example clearly shows that the 75:25 agreement is less risky for the landowner but also less rewarding if an excellent result is experienced. It is up to landowner and tenant to decide on the risk / reward agreement that best suits their situation.

Share farming agreements are usually short-term and are frequently annual. A one year agreement may encourage the farmer to achieve the highest gross margin without reference to the affect on future years. An ideal share farm agreement will be for a period similar to a rotation e.g. a 3 year crop rotation.

e.g. year 1 – canola
year 2 – wheat
year 3 – barley

A term which is consistent with the rotation provides a fairer outcome to landowners and sharefarmers.

A share-farm agreement could be a mix of lease at a low rate plus a percentage of gross income providing a similar outcome to the participatory lease.

6.5 Grazing leases – stocking issues

For land leased for grazing the economic principles are similar to land leased for cropping. The main difference is that extra **stock capital** is needed. This contrasts with many leases for cropping land where the where the tenant does not have to buy extra stock or machinery as they are able to utilise existing machinery more efficiently.

Currently sheep prices are at an all time high and consequently farmers contemplating a grazing lease might be deterred by the capital outlay required. The tenant also faces the risk that stock prices fall at the end of the lease when stock may have to be sold.

Example – grazing lease

- Area = 450 ha.
- Effective Area = 400 ha.
- Average Rainfall = 550mm (in SW Victoria)

Stocking rate

- Running 2.5DSE per hectare per 100mm of rainfall
- *Formula = 2.5DSE x (rainfall mm/100mm)*
- Stocking Rate Required = 2.5 x (550mm/100mm)
  = 13.75DSE/ha.
- Total DSE Required = 13.75 DSE/ha. x 400ha.
  = 5,500 DSE

The land is suited to running a medium wool merino sheep which are joined to merino and cross bred rams in order to be self-replacing.

Stock and capital required

	No.	DSE	TOTAL DSE	Value $/hd.	Total $'000
Ewes - mixed cfa	2,650	1.8	4,770	140	371
Ewes -maiden	550	1.1	605	110	61
Rams	50	2	100	600	30
Total	**3,250**		**5,475**		**462**

Key assumptions

- **Total DSE's = 5,475 DSE's**
- **Interest expenses** = $462,000 x 8% = $36,960 / 5,475 DSE = **$6.75 / DSE**
- **Fertiliser** = the tenant is also required to apply 110kgs/ha. of superphosphate = 400 ha. x 110 kgs/ha. = 44 tonnes @ $390/t delivered and spread = $17,160.

  Fertiliser = COST/DSE = $17,160 / 5,475 DSE = **$3.13 / DSE**
- **Actual stocking rate** = DSE / Hectares of Effective Area
  = 5,475 / 400
  = **13.69 DSE / Hectare**

Expected gross margins

Stock Plan	No.	
Open No.	3250	85% lambing of 2,650 ewes
Births Mo	1125	
XB	1125	
Purchases	12	$10,000 incl. delivery ($833 each)
Total	**5512**	
Sales	2132	ewes/cfa 482 @ $80/hd.
		XB lambs 1,100 @ $100/hd.
Deaths	130	Mo wether lambs 550 @ $80/hd.
Close No.	3250	**Total Sales**
Total	**5512**	

	$'000
ewes/cfa 482 @ $80/hd.	38
XB lambs 1,100 @ $100/hd.	110
Mo wether lambs 550 @ $80/hd.	44
Total Sales	**192**

Wool Income = 3,200 @ 5kgs/hd. = 16,000 x $5.50 = $88,000

Gross margin - Sheep

Income	**$'000**
Wool	88
Sheep Sales	192
less Purchases	-10
Total	**270**
Direct Costs	
5,475 DSE x $15.52*****	85
Gross Margin before Interest and Fertiliser	**185**

*****$15.52 is the 'Prime lamb enterprise cost' for the South West in 2009/10[37]. The average of the South West Farm Monitor Project is used for costs which involve using contractors for shearing and crutching. If the tenant does this work himself then the same rates are used as for the South West Farm Monitor Project, thereby ensuring a fair return for the extra labour used for shearing and crutching.

	$
GM $/DSE before interest	**33.79**
Less Interest Expense	(6.75)
Gross Margin after Interest	**27.04**
less Fertilizer Cost	(3.13)
Gross Margin after Interest & Fertiliser	**23.91**
GM/ha. = $23.91 x 5,475 DSE	**130,907**

- Rental Value @ 50% of Gross Margin = ($23.91 / 2)/5,475 DSE
  = $65,453 ($11.95 / DSE)
- Rental Value per total hectares = $65,453 / 450ha. = $145.45 per ha. ($58.86/acre)
- Rental Value per effective hectare = $65,453 / 400ha. = $163.63 per ha. ($66.22/acre)

[37] Livestock Farm Monitor Project Results 2009/10 – www.dpi.vic.gov.au

Return to land owner

- Land Capital = 450 ha. x $3,000/ha. = $1.35m
- Rent = $65,453
- Gross Rate of Return = 4.85%
- Value of Grazing Land/DSE = $1.35m/5,475 DSE = $247/Dry Sheep Area

Return to tenant

Calculation of working capital

Tenant capital:

Tenant capital	**$**
Stock	462,000
Working capital (average)	97,000
Total capital	**559,000**

Working Capital:

Working capital	**$'000**
Stock	85
Fertiliser	17
Administration	10
Lease	65
Interest	17
Total	**194**
Average / 2 (@ 8%)	**97**

Return to Tenant

	(a)	**(b)**
	$'000	**$'000**
	100%	*20%*
Return - 5,475 x $33.79/DSE	185	185
Less		
Fertiliser	17	17
Admin. & Interest	18	18
Lease	65	2
Interest on Stock	37	37
Total Costs	**137**	**74**
Net Income	**48**	**111**

Notes:
(a) Lease is 50% of Gross Margin
(b) Lease is $2,000 and tenant earns 20% of the return.

- **Rate of Return on Capital** = $48,000/$559,000 x 100 = 8.6%
- **Rate of Return on Capital** (if land owner pays for fertiliser)
  = $45,000 + $17,000)/$559,000
  = $65,000/$559,000

= 11.63%

- **Rate of Return on Capital** (before interest on stock capital)
  = $48,000 + $37,000)/$559,000
  = $85,000/$559,000
  = 15.2%

Alternative scenario

If the lease rate was 33.3% of gross margin the landowner would receive:

Gross Margin = $130,907 x 0.333 = $43,635

Rate of Return = $43,635/$1.35m = **3.23%**

Return/ha. = $43,635/450ha.
= $96.97/ha.
= $39/ac

The tenant would receive	$130,907
less Lease	$43,635
less Admin. & int.	$18,000
Tenant Return	**$69,272**

Tenant return **= $69,272 / $559,000**

= 12.39%

Conclusions

There is no doubt that the current high stock values create many problems for determining a fair grazing lease.

Based on a lease price of 50% of the expected gross margin a potential tenant is unlikely to borrow to buy stock for a lease as the return is low at 8.6%.

Even if a tenant had sufficient stock so that they did not have to borrow, a return on working capital of only 15.2% is not attractive.

If the tenant required a reasonable return on working capital of 20%, they would need a return as follows: 0.2 x $559,000 = $111,800. This return would be achieved if the rent was reduced to $2,000 p.a., a return which would be acceptable to a landowner.

If the landowner pays for the fertiliser then the return increases to 11.63% for the tenant. However the fertiliser cost decreases the return to 3.6% for the landowner ($65,000 - $17,000 (fertiliser)/ $1.35m = $48,000 / $1.35m = 3.6%).

The land value of $3,000/ha. or $1,200/acre is currently on the low side as it represents $246/dry sheep area.

This analysis suggests that grazing values are high relative to returns, and owners of grazing land who seek to lease that land are likely to expect lower lease rates.

50% of the Gross Margin is too high a lease value to pay when stock values are high.

With high stock values tenants are unlikely to borrow to buy stock and then pay 50% of the GM/ha for the lease.

6.5.1 Leasing stock

A landowner who owns stock and a grazing property and who has decided to lease out the land may also wish to lease out the stock, rather than sell them. Often, when all stock are sold in this situation, a high tax profit is generated as the stock are usually valued at a low rate for tax purposes. In these circumstances the tenant usually agrees to lease the stock for the term of the lease and return the exact number and class of stock at the conclusion of the term.

The stock are usually leased at a rate which is about 5% above the bank bill rate. E.g. 90 day Bank Bill rate of 5% / Stock Lease of 10% (5% + 5%).

The value of the stock should be a realistic one and be net of selling costs, being ‘on-farm’ value.

A lease may also give the tenant a right to buy the stock at a fair market value during the lease or at the end of the term.

7. Legal aspects

It is important that people involved in a lease understand the effect that the legal ownership structures have on their rights and responsibilities. It is also important that lease agreements are prepared to cover all issues relevant to the conduct of a sustainable lease agreement.

7.1 Business structure

This section will examine the key aspects of business structure that are affected by a lease agreement. The type of structure that is the party to the lease has an effect on the risk and taxation implications that are faced by the proprietors.

Sole trader or individual ownership

In a lease agreement the land owner is the lessor and as such is a party to the lease. If land is owned by an individual and leased by another individual; then each of them will personally bear the responsibility for the lease. The income or losses earned as a result of the lease agreement are taxed in their hands. Any losses can be offset against any other income in their names. If the individual dies then the executors of their estate are responsible for the lease until the lease ends.

The assets of an individual are exposed to any loss incurred and an individual may not share income from the lease with others. An individual landowner could lease land to another entity e.g. a trust which in turn could sublet the land to a tenant.

Partnership

A partnership is not a separate legal entity and hence it is the individual partners that must enter into any lease agreement. A partnership therefore has similar legal characteristics to that of the individual i.e. losses and or income are those of the partners and an individual partner's assets may be exposed to any liability arising from the lease. Partnerships are inexpensive to set up and administer. However partners may be exposed to liability arising from the actions of their partners whilst acting on partnership business.

Companies

A company is a separate legal entity which is owned by the shareholders and managed by the directors. In family companies the shareholders and directors are frequently the same people. A company may have a single director.

Companies are subject to Corporation Law and hence directors must have knowledge of this law if they are to conduct the affairs of the company properly. Directors may be personally liable for the debts of the company if they permit the company to continue trading if they know or suspect that the company cannot pay its debts when they are due and payable.

Company directors and shareholders have limited liability if they conduct their affairs properly in the name of the company.

It is not advisable to own appreciating assets in the name of the company as many tax problems may arise in the event of a capital gain being made. If a company is used as a party to a lease the landlord is likely to require personal guarantees from the director/s of the company for payment of rent and performance of the terms of the lease.

The company structure has merit in limiting the liability of the shareholders against people with whom it does business.

Companies are taxed at a flat rate of 30% and income is distributed to shareholders as dividends. Shareholders in receipt of company dividends are not eligible for the primary producer tax benefits of averaging and Farm Management Deposits.

Trust

A family discretionary trust with a company acting as trustee is currently the most desirable structure for constructing a profitable business.

A trust is created when a settlor provides a sum of money ("a settled sum") to a trustee with a request that it hold the money and any other assets transferred to the trust for the benefit of the beneficiaries, at the same time a trust deed is signed. The deed is a legal document which names the trustee and the appointors – who appoint the trustee, beneficiaries and property, and provides for the trustees to manage the property in a manner set out in the trust deed.

A trust may own land or simply own working assets such as stock and plant. If a company is used as trustee then the directors of the company have limited liability and or responsibility for managing the trust's affairs.

The trustee (often a company) enters into contracts on behalf of the trust.

The trust described above has the advantage of creating discretion as to the distribution of income. It cannot however distribute losses to individuals as a partnership can. The costs to set up and operate a trust are higher than for a partnership.

Two trusts could act in partnership if two families wished to enter into a joint venture together.

A person who owns land and is considering entering into a lease agreement may consider transferring the land into a trust for succession and income tax reasons. However the capital gains tax and stamp duty implications need to be considered before making such a move. In some States, land may be transferred to a trust without stamp duty expense if the trust names only a narrow class of beneficiaries including the children of the landowner.

The CGT implications are complex and professional advice needs to be obtained before a decision is made.

A more detailed commentary on business structures and the manner in which they are taxed can be found in the RIRDC publication "*Farm Business Structures and Sustainability Issues*".

7.2 The lease agreement

Chapter two provided a list of the essential contents of a well drafted lease agreement. This section will now discuss these issues in more detail. (See Appendix 2 for an example of a lease agreement.)

Item	Information to be covered
The parties to the lease	The full names of the individuals need to be provided together with their trading ABNs. (If a company the name and ACN).
Subject land	The area on the title and a title description. If the area is not a complete title or land is to be excluded, then a detailed map describing the land and its area.
Rent	The total amount of the rent per year and when it is payable. Quarterly or six monthly in advance is most common.
The term	The duration of the lease and the starting date.
Options for further term	The lease may provide for the tenant to have an option to extend the lease for a further term in which case the duration of the further term and the method by which the rent is to be determined need to be set out, as well as the notice required prior to the end of the term (at least 6 months).
Permitted use	The use of the land by the tenant that is allowed by the lease.
The landowner's obligations	Usually agrees to give the quiet enjoyment of the property to the tenant and only visit the property after giving notice to the tenant. Frequently pays rates and insurance, provides GST invoices for the rent.
The tenant's or lessee's obligations	To pay the rent when due. To maintain land and buildings and all other structures in the condition they were in at the commencement of the lease (fair wear and tear excepted). To manage the land in an acceptable manner and to provide to the landowner each year a schedule of land use and stock carried. To keep stock free from disease. To maintain fire breaks. To control all rabbits and noxious weeds. To insure against: • public liability, $10m minimum; • crops damage; and • workers compensation. Not to fell timber or damage plantations. To apply fertiliser at a prescribed rate (e.g. $4/DSE). Not to crop greater than XX hectares nor carry more than YY DSE.

Item	Information to be covered
The tenant's or lessee's obligations (cont.)	Maintain public liability insurance. To pay legal costs and stamp duty if payable (not in Victoria). Not transfer the lease without the landlord's consent.
Dispute resolution	A process is described whereby disputes can be resolved using an independent expert. Disputes usually arise as the result of a lack of detail at the time the lease is set up and/or a lack of attention to ongoing management.
Desirable conditions	It is desirable that a condition report is prepared at the start of the lease (see enclosed example provided in the next chapter); and that each year the property is inspected by the person who prepared the report. The cost of these reports could be shared by landowner and tenant. A report prepared using a digital camera and containing many photos is relatively easy to prepare and is excellent evidence.
GST	States whether the lease is subject to GST (Note: Most leases will be subject to GST)

8. Best practice in rural leasing

This chapter considers best practice before and during any lease arrangements.

8.1 Planning for sustainability and profitability

A well organised business will have developed clear business objectives as part of a comprehensive **business plan**. Ideally the business plan will focus on the sustainable management of the farm, how it will remain viable, and the role that leasing will play as a part of the plan. A well prepared business plan places emphasis on meeting market needs in a profitable manner.

A business plan should be prepared for both the landowner and tenant.

Set out below is an outline of a business plan followed by comments on how it can be adapted to reflect sustainability and the impact of a lease on the plan.

A Business Plan

The content of a business plan is set out below. Please make your notes below:

		How I will plan for sustainability and profitability on my farm and leased land.
1.	**Executive Summary**	
2.	**Table of Contents**	
3.	**Statement of Business Objectives** • Mission Statement • A set of 'SMART' objectives	
4.	**Business Profile:** • History • Land resources • Facilities • Pasture management and utilisation • Livestock management • Crop management • Plant and machinery • Labour management • Calendar of events • SWOT analysis of the business • Current financial performance	
5.	**Market Analysis** • Market size • Market segmentation • Market growth potential • Seasonality • Competition • Market outlook • SWOT analysis of the market	
6.	**Marketing Plan**	

		How I will plan for sustainability and profitability on my farm and leased land.
	• Setting marketing objectives • Marketing strategies • Market risk • Sources of market information • Measurement of marketing objectives	
7.	**Organisation Plan** • Communication planning • Succession planning • Management planning • Organisational planning • Training • Administration	
8.	**Production Plan** • Land use and crop rotations • Timing and reasoning for animal husbandry • Calendar of events • Machinery requirements and ownership • Human resource planning • Quality assurance • Production risk	
9.	**Implementation Schedule** • Timing capital improvements • Work planning • Cash flow and peak debt	
10.	**Research and Development Plan** • Product and service development • Strategic alliances • Resourcing	
11.	**Financial Plan** • Investment analysis • Financing • Financial projections • Benchmarking • Business risk	
12.	**Conclusion and Recommendations**	
13.	**Bibliography**	

	How I will plan for sustainability and profitability on my farm and leased land.
14. Appendices	

Now compare your notes with those provided below. The content of this business plan may be adopted to ensure that a sustainable and profitable business is developed. Each area of the business plan needs to reflect sustainability issues. Key aspects are set out below.

Adopting a business plan for sustainability and leasing

Mission Statement	Incorporated into this statement needs to be a statement about the proprietor's commitment to the production of "clean green produce", from a farm system that is both sustainable and profitable.
Analysis of the Business	An audit needs to take place of the existing business to determine the sustainability of the resource management and its impact on the environment. This audit needs to incorporate a 'report card' as described in chapter 4.
Market Analysis	As well as a view being developed on the market outlook it is valuable to know what premiums or discounts may or may not apply to produce which are quality assured both from the perspective that they are free from contamination and from the view that they are produced in an environmentally friendly way.
Organisational Plan	All staff involved in the business need a commitment to the new system. This will involve leadership from the manager and training for all staff. An EMS system needs to be developed for the farm. This EMS is likely to be a component of the total system described in the previous section. The EMS component emphasises the impact that the farm has on the environment and hence those components of the sustainable and profitable farm system relevant to EMS need to be identified and "packaged".
Production Plan	It is vital to have a measurable means of ensuring that produce is of high quality and free of contamination, and has been produced by a means that protects the environment.
Market Plan	A logo or brand could be developed to help differentiate your products. The logo or branding of produce needs to reflect your environmental focus. Whether or not you receive a good return on this marketing outlay is an issue which may encourage or discourage your adoption of an EMS. Your commitment to EMS is a vital long-term issue. It is desirable that the system is adopted by all those involved in the supply chain.

Financial Plan	Compare the budget for the business both before and after any lease under consideration is taken into account. Refer to Table 9 in the Jones case study for an example. Also assess the risks associated with the lease and identify ways of countering them.

8.2 Pre-lease preparation – assessing the property

In addition to preparing a business plan which incorporates the lease and sustainability principles it is desirable that a comprehensive assessment is made of the lease property and that the lease agreement fairly reflects the condition of the farm at the start of the lease.

We provide below a checklist of issues to consider when inspecting a prospective lease, and an example of a **condition report** prepared pre-lease. The condition report will ideally include detailed notes on the condition of land and improvements. For an example refer to Table 7.1 which shows a condition report for the Jones farm "Fairview".

This condition report could be prepared by an independent property manager and could be accompanied by a written report and photos. The photos could be incorporated into the report by using a digital camera and the report comments prepared by using a hand-held recorder used on the property inspection. The property manager could also be involved in annual property inspections at which time reference back to the initial condition report can be made.

Before the property is inspected a checklist of information about the property can be compiled as set out in the example Condition Report provided on the next page at 8.2.1.

Grading of Condition:
1. Poor condition – in need of upgrade now
2. Below average – barely adequate will need attention within 3 yrs
3. Average – should be OK for 3 years+
4. Good - should be OK for many years
5. Excellent

8.2.1 Example - Condition Report

The lease property (Fairview 450 ha)

REPORT PREPARED BY: *R.G. Ashby & Co. Pty Ltd*

DATE: *January 2011* **Rainfall:** *500 mm pa*

		Water Supply					
Area ha	**Paddock No**	**Troughs**	**Mills**	**Dams**	**Fences**	**Pasture**	**Comments** – all land is in pasture
	1			*3*	*2*	*1*	*Heavy infestation of annual grasses (AG)*
	2			*3*	*2*	*1*	*AG 50% broad leafed weeds 50% (BLW)*
	3			*2*	*2*	*2*	*25% improved grasses perennial ryegrass (PRG) + 75% AG*
	4			*2*	*2*	*2*	*25% improved grasses (PRG) + 75% AG*
	5			*3*	*1*	*3*	*50% PRG, 50% AG*
	6			*3*	*2*	*3*	*50% PRG, 50% AG*
	7			*2*	*2*	*1*	*50% AG, 50% BLW*
	8			*2*	*3*	*1*	*50% AG, 50% BLW*
							General comments – All pastures are fair to poor. Some fences need
							Removing. Visually the land demonstrates low P & N levels.
							Annual grasses are principally, Silver grass, Barley grass and Wimmera
							Ryegrass. Broad-leafed weeds are principally capeweed on hills and
							Thistles in lower fertile areas. There are significant areas of onion grass
							Present throughout.

Type of country:

- Undulating clay loam over clay subsoil, of volcanic origin. The land was cleared of stone in the 1960's. Can get wet after heavy Winter/Spring rain.
- Drainage occurs via a creek which runs through the property and via some old open drains that do not function properly.

Other Building Improvements:

Building	**Condition**	**Comments**
Not leased		

8.2.2 Pre property inspection checklist

The following detailed information is needed prior to undertaking a property inspection of a potential lease property:

- Names and addresses of landowner and tenant
- Availability of a map and accurate assessment of areas including the effective area
- Tenure; when payments are to be made; date of possession; and right of renewal
- Obligations as to:
  - standard claims relating to repairs
  - financial obligations
  - special clauses e.g. fertiliser
  - Access – for the farmer and owner
- Special clauses re farming practices e.g.
  - fertiliser use
  - area to be cropped
  - number of stock
- Condition of all land and improvements at the commencement of the lease
- Lease agreement includes a process for ongoing management and dispute resolution
- Lease land needing capital investment
- If the condition report identifies need for capital investment the landowners can decide on whether they wish to invest capital into the land being offered for lease or whether they expect a lower lease rate to permit the tenant to make necessary improvements.

Example of a lease property in need of capital improvement:

If the condition report reveals a need to invest capital to ensure that the property is productive and properly maintained then the capital cost can be allocated as follows.

Example – case study – 300ha lease property, 9 year term

Capital Improvements	**$**
Re-sow pastures 150 ha @ $160/ha	24,000
Remove old fences and repair fences	5,000
Repair lanes and gateways	5,000
TOTAL capital needed	**34,000**
Interest @ 8%	2,720
Amortised cost over 9 years @ 8% ($34,000 x 0.1601) =	**$5,443 p.a.**

See enclosed condition report.

If the tenant is to provide this capital then the rent should be reduced by $5,443 per year or $34,000 could be reduced from the rent in year 1 and 2.

8.3 Leasing checklists for landlord and tenant

The importance of the business plan and condition report have been highlighted. It is now useful to provide you with a final summary of the leasing process – from start to finish.

Leasing – how to proceed

The Landowner	The Tenant
1. Prepare a **business plan** to identify what role the property and its likely rental income will play in the long-term plan.	**1.** Prepare a **business plan** which identifies the role that a lease will play in the business and what represents a fair rent.
2. If leasing is your chosen path, undertake a **property assessment** to determine if capital needs to be invested and if so how much and how it may be funded.	**2.** Seek out a suitable property. If none are advertised approach neighbours.
3. Dates – choose a suitable date for the lease commencement – Autumn or late Summer are usual times. They coincide with the start of season.	**3.** Inspect potential lease property.
4. Method of offering the property – Decide if you are going to offer the land to a group of selected neighbours and or whether you will advertise. Provide at least 3 months and preferably 6 from advertising to occupation.	**4.** Prepare a plan and budget incorporating the lease into your current business. Identify how much extra working capital is needed.
5. Invite expressions of interest in order to determine potential tenants.	**5.** Prepare a plan which can be submitted with an expression of interest. Include in the plan:
6. Select a short list of potential tenants and interview them and their referees. Inspect the property with them. Request the tenant to outline their proposed farm system.	an outline of your current business – legal owners, type of business, history proposed land use and stock numbers cash flow budgets if profit sharing is to occur
7. Choose a tenant – base the choice on the quality of their application, how they manage their own property and their financial strengths.	list of referees – include bank manager/ accountant
8. Identify an independent consultant to prepare a **condition report** on the property. Provide copies of the report to the tenant.	**6.** Obtain a copy of the condition report and respond either to acknowledge that it is satisfactory or to resolve any potential problems.
9. Provide a **tax invoice** at the start of the lease to the tenant. **10.** Arrange a hand over date.	**7.** Provide an annual statement of land use and or verification of the lease conditions e.g. proof of fertiliser application.
11. Identify an inspection review data and the reports that will accompany it e.g. land use and fertiliser application proof.	
Finally – Give the tenant "quiet enjoyment".	***Finally – we wish you excellent seasons and prices.***

8.4 Managing problems during and after the lease term

Once a property has been satisfactorily leased it is important that the lease continues to be managed in an appropriate manner.

After the farm is leased then the property should be inspected periodically and not less than annually. The use of an independent adviser is preferable. The inspection will ideally occur in late winter when the property is usually low on feed and stressed.

The adviser will ideally identify any areas of conflict and potential conflict and provide a sample means of conflict resolution in writing to both parties. *(Please review Bob Hall's views – A Consultant's View at Section 8.6).*

An annual meeting is recommended between landlord, tenant and adviser to discuss and resolve any ongoing management issues. The focus of the annual meetings is to ensure that problems do not build up and create conflict at the end of the lease.

Farmer feedback suggests that the topics of maintenance and weed management are the two most frequently occurring problem areas. This is why it is vital that a condition report is prepared at the beginning of the lease to identify issues and provide a base-line for the ongoing management of the lease.

The cost of the independent adviser could be shared between the parties.

8.5 A consultant's view on lease management

You will benefit by following the advice provided by an experienced agricultural consultant Mr Bob Hall, Darkan, W.A.[38]. The following are his views on lease management.

Landlord (lessor) management

A wise landlord (lessor) will manage the lease as follows:

- Choose a tenant based on the manner the tenant's farm is run.
- Make sure that the tenant makes a profit.
- Will consider the property not just the profit.
- Invest a% of the rental income back into the property (ideally 10%)
- Will take a long-term perspective.
- Will employ an adviser to represent him as an agent.
- Visits the property occasionally.

A wise tenant (lessee) will act as follows:

- Farm the land in the same manner as if it was owned.
- Will not cheat.
- Communicates openly and honestly with the landowner.

To the above comments we could add that we would like sufficient investment into the measurement and ongoing assessment of sustainability criteria as part of the investment of a portion of rental income back into the property by the land owner.

[38] Comments at Australian Association of Agricultural Consultants conference, held at Mandurah, WA, August 2001; and on a tour of leased properties; and reviewed in December 2010.

9. A case study – the Jones family farm business

9.1 Introduction

This is a study of a family farm business. All the family members would like to expand the business but are keen to do so in a manner which is sustainable both in terms of its agricultural productivity but also in terms of the participation of the next generation.

9.2 The case study details

The family

Bill and Jane Jones are both aged 53 years and own and manage a farm business in central Victoria. They have two children, a daughter Mary aged 25 years, who is a qualified accountant and works in Melbourne, and a son John aged 23 years who works for a local stock and station agent. John has been in the same job for the last two years since leaving agricultural college. He has recently become engaged and is keen to settle into his career. John has recently been offered work promotion which would involve him in moving to southern NSW. This promotion would be a good career move if he remained in the agency business. John would prefer to become involved in the family farm business; however he is aware that the farm does not currently have the scale to support two families.

The farm

The farm is 1,200 ha of freehold land and comprises mostly gently undulating volcanic soils of which 1,100 ha is arable.

The region experiences approximately 500mm of annual rainfall which is mainly Winter/Spring dominant.

The farm enterprises are a medium wool merino flock joined to merino and Border Leicester rams and a cropping operation. Contractors are used for spraying and harvesting.

The business

The business is run as a partnership – W.A. and J.J. Jones. Profits have been very variable in the last 10 years – very high in 2002/03 and losses in 2006/07.

The partners would like to expand and involve John and his future wife in the business. They do however have several concerns which include:

- They expect commodity prices to be very volatile in the next few years and interest rates to rise.
- They have willed their assets equally to John and Mary and are concerned that this may create insoluble problems for John if he takes over the farm operation.
- Farm machinery is aging.
- The partners hold no non-farm assets.

Options

- If John does not come home Bill would consider reducing machinery and using a contractor for cropping.
- The business could be expanded by the purchase or lease of extra land and the hire purchase of an upgraded set of cropping plant.
- The land that is available for lease or purchase is run down. It has low fertility, poor fences and weedy pastures. It has not been cropped for many years although it is all arable and capable of regular cropping.

9.3 Farm finances

Assets and liabilities

Table 9.a Statement of Assets and liabilities for W.A. & J.J. Jones

	As at 1/07/2000 $'000	As at 1/07/2010 $'000
Assets		
Land - 1200 ha @ $2000/ha; $3500/ha	2,400	4,200
Stock - 6000 sheep @ $40/hd; @ $100/hd	240	600
Plant and machinery	100	200
Supplies	10	20
TOTAL Assets	**2,750**	**5,020**
Liabilities		
Tax including GST	20	-
Bank loan 8% fixed	180	180
RFC loan – interest 7.5%	200	150
Hire purchase	-	100
Overdraft	50	90
TOTAL Liabilities	**450**	**520**
Net Worth	**2,300**	**4,500**
Equity	**84%**	**90%**

Over the 10 year period net worth has grown from $2.3 million to $4.5 million, an increase of 1.956 times, which represents a compound rate of growth of 7%.

Farm plan for 2010/11 – no change

Table 9.b Stock plan

	No
Open No	6,000
Births – Merino	1,000
Births – X-Bred	1,000
Purchases	8
Total	**8,008**
Sales	1,760
Deaths	248
Close No	6,000
Total	**8,008**

Open No. DSE		**DSE**
Ewes 2500 x 1.5 DSE	=	3,750
Other 3500 x 1.0DSE	=	3,500
Total DSE	=	7,250
Rams 8 x $500	=	$4,000

	Sales	**$**
Culls and c.f.a.	600 x $80	48,000
Wethers – Mo	310 x $70	22,000
Wethers – XB	450 x $80	36,000
Ewes – XB	400 x $120	48,000
		154,000

Table 9.c Wool income

March shearing 20-21m wool, Spring lamb		
5800 x 4.5 kgs	=	26,100 kgs
1000 ewe weaners x 2 kgs	=	2,000 kgs
Total		**28,100 kgs**

Budget wool price – based on 950¢/kg for 20.5m		
$5.70/kg =	=	$160,170

Table 9.d Land use and stocking rate

Land Use	**Ha.**
Total area	1,200
Waste and non farmed	20
Effective area	**1,180**
Crop	460
Pasture	720
	1,180

Stocking Rate =	7250 DSE/10.07 DSE/ha. = **720**

Table 9.e Crop plan

Crop	Area ha	T / ha	Tonnes	On farm $/t	Total $'000
Wheat	115	3	345	250	86
Canola	115	1.8	207	450	93
Peas	115	2	230	300	69
Barley	115	3	345	220	76
	460				**324**

Cash budget 2000/01, 2010/11

Table 9.f Cash budget 2000/01, 2010/11

Income	**2000/01 $'000**	**2010/11 $'000**
Wool	150	160
Sheep – sales	45	154
– purchases	(4)	(4)
Crop	234	324
Rebates and sundry	10	10
TOTAL Income	**435**	**644**
Costs		
Overhead – land and admin	60	90
– R & M, fuel & oil	50	80
Sheep	40	72
Crop	115	164
Pasture	12	30
TOTAL operating costs	**277**	**436**
Finance – loans interest	30	26
– chattel mortgage	-	22
– overdraft interest	8	14
TOTAL operating and finance	**315**	**498**
Cash surplus from operation (Farm Cash Income)	**120**	**146**
Less		
Drawings	50	70
Tax	20	10
Loans principal – RFC	17	17
Loans principal – Bank	18	-
Machinery replacement	15	20
Total Capital / Tax / Drawings	**120**	**117**
Cash surplus	**0**	**29**

Discussion and sustainability report card

Based on the outlook for 2010/11 and assuming an average rainfall year, the farm performance is forecast as follows:

A cash surplus from operations of $146,000 is forecast. Adequate allowance has been made in the costs for fertiliser and lime application to either maintain or improve soil productivity.

The cash surplus is to be used for:

Drawings and tax	$80,000
Repay loans	$17,000
Replace machinery	$20,000
Cash Surplus	$29,000
Total	**$146,000**

Hence the farm business is forecast to provide an adequate living to the partners, maintain productivity and repay some debts.

The gradual reduction in the debts will provide a gradual increase in net worth and equity percentage.

Sustainability issues:

The key sustainability issues which need to be addressed on a continuing basis are:

- soil acidity;
- salinity in streams;
- the need to focus management on biodiversity;
- the aging nature of the workforce i.e. Mr and Mrs Jones; and
- the decline in the provision of services in the region.

Table 9.g Sustainability report card

			Trends				
Indicator	*Attribute*	**Measurement**	**Ver**	**Goo**	**Fair**	**Poor**	**Very**
Long-term Net							
Overall trend ↕	Farm business profit	$95,000		•			
	Farm debt	$520,000					
	Equity	90%					
	Rate of return	2.1%		•			
Natural resource	Nutrient balance P:K	P 13ppm			←•		
Overall trend ↕	Soil acidity and sodicity	5.0 pH in $Cacl_2$				←•	
	Conservation area	8%			←•		
	Ag species diversity	-			←•		
Off site impact	Chemical residue	Nil	•				
Overall trend ↕	Salinity in streams	EC 1200				←•	
	Impact on native	-		←•			
Managerial	Farm education	Extensive			•		
Overall trend ↕	Participation in training	20 hrs pa		←•			
Socio-economic	Age structure	53 y.o.			•		
Overall trend ↕	Access to services	-			•		

9.4 Farm expansion

Options

The family is in the fortunate position whereby an arable property of 400ha only 2kms away has become available for sale or lease. The current property owners (the Browns) are in their late 60's and have decided to retire from farming. They are friends of the Jones family and have made the following comments.

Comments made by the Browns

- They would be happy to sell the farm if they could achieve a sale of $1.5 m (i.e. $3750/ha or $1500/ac). This is how much they need to buy a retirement house and invest to provide a pension. However they are concerned about poor returns from superannuation and investing in areas where they have no experience.
- The market value of the property is probably around $3000/ha ($1200/ac) or $1.2 million in total. Many of the fences on the property are falling down and the pastures are poor and have low fertility levels. The soils are also quite acidic.
- They would consider leasing the property if:
- they could remain living in the homestead; and
- they received an adequate rental income for their retirement needs.

The Jones would like to buy the property but are not willing to pay $1.5 m in order to do so. They will analyse the options and put a proposal to the Browns. They consider that $1 m is the most that they would be willing to pay for the property.

If they acquired the land they would only do so if the expansion was a sound commercial decision and it facilitated John's involvement in the family business and the eventual retirement of Bill and Jane.

Alternatively, based on local lease values, a lease of $65,000 pa or $65 / acre would be reasonable.

Farm plan and budget 2010/11 – buying or leasing

Land use – leased land

- Affect of the lease or purchase on the farm plan.
- All of the land would be cropped.
- Expected income - 400 ha – 360 ha effective

Crop	Area ha	T / ha	Tonnes	On farm $/t	Total $'000
Canola	180	1.6	288	450	130
Wheat	180	2.8	504	250	126
	360				**256**
Crop direct costs are estimated @ $350 / ha =					**126**
Budgeted lease gross margin =					**130**

Table 9.h Assets and liabilities: the affect of buying or leasing (W.A. & J.J. Jones)

	As at 1/7/2010 No Change	As at 1/07/2010 Buying	As at 1/07/2010 Leasing
Assets	**$'000**	**$'000**	**$'000**
Land - 1200 ha x $2000/ha	4,200	4,200	4,200
400 ha x $2500/ha	-	1000	-
Stamp duty and legal	-	60	-
Stock - 6000 sheep @ $40	600	600	600
Plant and machinery	200	300	300
Supplies	20	20	90
TOTAL Assets	**5,020**	**6,180**	**5,190**
Liabilities			
Tax including GST	-	-	-
Bank loan 8% fixed + new loan	180	740	180
RFC loan – interest 7.5%	150	150	150
Vendor finance	-	500	-
Hire purchase / Chattel Mortgage	100	200	200
Overdraft	90	90	160
TOTAL Liabilities	**520**	**1680**	**690**
Net Worth	**4,500**	**4,500**	**4,500**
Equity	**90%**	**73%**	**87%**

Table 9.i Cash budget 2010/11

	Average Yields		
	Current	**Buy Land**	**Lease**
Income	**$'000**	**$'000**	**$'000**
Wool	160	160	160
Sheep	154	154	154
	-4	-4	-4
Crop – home	324	324	324
– new	-	256	256
Sundry	10	10	10
TOTAL	**644**	**900**	**900**
Payments			
Rent	-	-	65
Overheads:			
Land & administration*	90	100	90
R&M, fuel and oil	80	90	90
Hire purch. / Chattel mortgage	22	40	40
Sheep	72	72	72
Crop – home	164	164	164
– new	-	126	126
Pasture	30	30	30
Finance – loans	26	26	26
– overdraft	14	20	20
– new loans 8%	-	93	8
TOTAL operating	**498**	**761**	**731**
Cash Operating Surplus	***146***	***139***	***169***
Drawings & Capital Costs			
Drawings / Manager	70	100	100
Loans – RFC and Bank	17	17	17
Tax	10	-	-
Machinery replace	20	20	20
TOTAL Drawings & Capital Costs	**117**	**137**	**137**
TOTAL Costs	**615**	**898**	**868**
Cash Surplus	**29**	**2**	**32**

Add 2 DSE/grazed ha= 2 x 720 = 1440 x $20

* Rates and insurance paid by landowner

Discussion of expansion budgets

Land purchase

If the adjoining land was purchased using loans and an extra $100,000 spent on machinery finance by a chattel mortgage loan then:

- debt would rise to $1.68 million;
- equity would fall to 73%;
- a cash surplus from operations of $139,000 would result (a reduction of $7,000 from budget);
- minimal funds would be available to pay John;
- if a drought was experienced crop returns could be reduced by $100,000 and significant cash losses would result, which would have to be financed from debt further reducing equity percentage; and
- if a good year was experienced and land values increased net worth would also increase.

Land leasing

It is assumed that the land is leased for $65,000 pa under terms and conditions discussed in the next section. Additionally $100,000 is spent on upgrading plant as above. Using these assumptions:

- farm equity remains reasonable at 87%;
- cash surplus from operations is increased to $169,000;
- income tax is reduced as a result of increased depreciation allowances on machinery and income splitting between 4 partners;
- the farm can afford an extra $30,000 of drawings whilst still replacing machinery and repaying loans;
- if a drought is experienced and loss results, the losses can be funded from borrowings without reducing equity excessively; and
- with an average year at least $130,000 pa could be placed into superannuation for the parent's retirement or 5.4% of the market value of the house.

Leasing has clear benefits from a viability and cashflow perspective, provided the land can be secured for a long-term lease on reasonable terms.

9.5 Leasing issues

The Jones family decided to offer the following lease proposal to the Browns:

Leasing offer

- Lease term = 3 x 3 years, i.e. 9 in total
- Rent = $65,000/year or $162.5/ effective ha/year payable quarterly in advance. To be reviewed at the end of each 3 year term. The lease price represents 50% of the expected gross margin.
- The landowners may stay in the house hence its upkeep and that of the garden is the responsibility of the landowners.
- The landowners to pay rates and insurance.
- The tenant may remove some fences to facilitate more efficient cropping.
- An independent consultant will be retained to prepare a condition report on the property at the start of the lease and each year.
- The tenants may continue to crop the land provided annual testing indicates that the productivity of the land is either maintained or improved.
- The following tests will be undertaken:
    - Soils;
        - pH
        - P levels
        - K levels
        - S levels

    - Soil structure
    - Weed content – particularly wild radish and annual ryegrass
    - Fences
- The landowner agrees to the above terms and conditions.

The lease offer at $65,000 represents 6.5% of the Jones' valuation of the land, or 5.4% of the market value of the land.

If the Browns were to lease, they could sell stock and plant, repay the debt and place some funds into superannuation to supplement their rental income.

9.6. The future

The family agree to lease the Brown's land and expand the partnership by the admission of John as a partner via a family trust. John's partner will continue to work off farm.

The family have agreed that if John draws less than a proper wage for a number of years then the wills of Bill and Jane will be changed so that John receives in capital any income foregone. John has been earning a salary before tax of $55,000 p.a. or $48,000 p.a. after tax; hence the $30,000 drawing after tax represents a loss of $18,000 p.a. In addition John also will receive some perks. Hence the family will have to assess fairly the real income foregone by John.

The family will aim to reduce debt and build up superannuation. However once equity is above 88% then the business will use all available cash surplus building up nonfarm assets in the form of superannuation for the benefit of Bill and Jane in retirement.

The lease agreement and current management practices have ensured that the productivity of the land is assured. Finance policies need to focus on providing for Bill and Jane's retirement, John and his fiancée's succession and adequate provision being made in the will for Mary.

Appendices

Appendix 1 Environmental management objectives

Eight key environmental management objectives (VFF)

The approach used in this book can be assisted by reference to the Environmental Management Guide which indicates eight environmental management objectives (EMO). Each farmer can use this guide as a checklist in order to ensure that most if not all environmental issues are addressed. The eight EMOs used by the VFF are as follows:

Environmental Management Objectives developed by Victorian Farmers Federation

EMO1	**To conserve the productivity of land and soil**
EMO2	**To conserve waterways and water**
EMO3	**To minimise waste from on farm activities**
EMO4	**To conserve air quality**
EMO5	**to minimise the impact of noise in sensitive areas at sensitive times**
EMO6	**To conserve representative samples of native species and ecosystems**
EMO7	**To control pest plants and animals at manageable levels**
EMO8	**To consider the impact of farming activities on aboriginal cultural heritage policies and values**

The Guide encourages farmers to take all reasonable steps to achieve these objectives.

Appendix 2 Lease agreement example

The Lessor leases the land to the Lessee for the term and at the rent and on the conditions set out in this lease.

EXECUTED AS A DEED

DATE:

EXECUTION and ATTESTATION

1. DEFINITIONS and INTERPRETATION

1. This lease is to be interpreted according to the following rules:-

(a) Unless the contrary intention appears -

Guarantor	means the person or persons named in Item 10 of the Schedule.
Land	means the land and buildings and improvements thereon described in Item 3 of the Schedule and the lessor's installations.
Lessor	means the person or company named in Item 1 of the Schedule or any other person or company who will be entitled to possession of the land when this lease ends.
Lessee	means the person or company named in Item 2 of the Schedule or any person or company to whom the lease has been transferred.
Lessor's Installations	means the installations listed in Item 7 of the Schedule and those installed by the lessor after the lease starts.
Rent	means the amount stated in Item 4 of the Schedule.
Term	means the period stated in Item 6 of the Schedule.

(b) References to laws include regulations, instruments and by-laws and all other subordinate legislation or orders made by any authority with jurisdiction over the land.

(c) (i) The law of Victoria applies to this lease.

(ii) This lease must be interpreted so that it complies with all laws applicable to Victoria. If any provision of this lease does not comply with any law, then the provision must be read-down so as to give it as much effect as possible. If it is not possible to give the provision any effect at all then it must be severed from the rest of the lease.

(d) An obligation imposed by this lease or in favour of more than one person binds or benefits all of them jointly and each of them individually.

(e) The use of one gender includes the others and the singular includes the plural and vice-versa.

(f) If the lessor, lessee or guarantor is an individual, this lease binds that person's legal personal representative. If any of them is a corporation, this lease binds its transferees.

2. LESSEES OBLIGATIONS

2. The lessee must:-

(a) Pay the rent without any deductions to the lessor in the manner stated in Item 5 of the Schedule. No demand for rent is necessary and the lessor may direct in writing that the rent be paid to another person.

(b) Use the land in a good and husband-like manner.

(c) Carry out any cultivation and stocking of the land in accordance with good farm management.

(d) Top dress the land at a time and with the quantity of fertiliser at the rate specified in item 11 and in a manner which is consistent with good land management.

(e) (i) Take all reasonable steps to keep the land free of vermin and noxious weeds and comply with the law relating to them.

(ii) Give notice of all infectious illnesses to humans and livestock to the lessor and all public authorities as required by law.

(iii) Comply with at its own expense the requirements of all public authorities under the law regarding fumigation, disinfection, eradication and prevention of such diseases and with all requirements regarding the quarantining of livestock and its use of the land.

(f) Maintain any fire-breaks on the land at the date of this lease and such additional fire-breaks as may be necessary to prevent the spread of fire and comply with any direction of the municipality or responsible authority concerning fire prevention.

(g) Comply with all laws relating to the use or occupation of the land.

(h) Keep any chemicals, inflammable fluids and other hazardous things on the land in a safe and secure manner and in accordance with the law

(i) Pay on demand the lessor's reasonable expenses of:-

(i) the preparation and execution of this lease;

(ii) the change, transfer, surrender or ending of this lease, except at the end of the term, or where the change occurs at the lessor's request;

(iii) the sub-letting of the land;

(iv) any breach of this lease by the lessee; or

(v) the exercise or attempted exercise by the lessor of any right or remedy against the lessee.

(j) Pay on demand interest at the rate prescribed by the Penalty Interest Rates Act 1983 from time to time on any rent or other money which the lessee has not paid within 7 days of the due date which interest will be calculated from the due date and continue until the overdue money is paid.

(k) Indemnify the lessor in respect of any statutory charge paid by it as a result of the use of the land by the lessee.

2.1 The lessee must not and must not let anyone else:-

(a) Use the land except for the purpose stated in Item 8 of the Schedule.

(b) Do anything which might cause nuisance, damage or disturbance to any adjacent land of the lessor or occupier.

(c) Make any alteration to the land or the lessor's installations without the lessor's written consent.

(d) Create a fire hazard as a result of the use or occupation of the land.

(e) Do anything which might affect any insurance policy relating to the land of the lessor's installations by causing:-

(i) it to become void or voidable;

(ii) any claim on it being rejected; or

(iii) a premium to be increased.

(f) Destroy any growing timber on the land.

(g) Permit the land to become pugged or the structure of the soil on the land to be damaged by livestock.

(h) Use any chemical treatment or spray which may adversely affect the use of the land at the end of the lease.

(i) Not introduce or cause to be introduced any fodder, noxious weeds or other things which may affect the use of the land at the end of the lease.

(j) Excavate or remove timber, gravel, top soil or other materials from the land without first obtaining the permission of the lessor.

3. REPAIRS and MAINTENANCE

3. The lessee must repair and maintain any buildings and improvements and all fences, tracks, roads, bores, windmills, water pumps, dams and drains on the land and keep them in the same condition as at the start of the lease (fair wear and tear excepted).

3.1 In addition to the obligations contained in clause 2 the lessee must:-

(a) Promptly give written notice to the lessor of -

(i) damage to any of the lessor's installations; and

(ii) service by any authority of a notice or order affecting the land.

(b) Permit the lessor, its agents or workers to enter the land:-

(i) to inspect the land;

(ii) carry out repairs or agreed alterations;

(iii) to do anything necessary to comply with notices or orders of any authority;

(iv) plant trees; and

(v) water and maintain plantations.

(c) Carry out repairs within 14 days after being served with a written notice of any defect or lack of repair which the lessee is obliged to make good under this lease. If the lessee does not comply with the notice, the lessor may carry out the repairs and the lessee must repay the cost to the lessor on demand.

3.2 The lessee is not obliged to carry out structural repairs or make payments of a capital nature unless the need for them results from:-

(a) Negligence by the lessee or its employees, agents, contractors, customers or visitors; or

(b) Failure by the lessee to perform its obligations under this lease; or

(c) The lessee's use of the land.

4. TRANSFER OF LEASE AND SUB-LETTING

4. The lessee must not transfer this lease or sub-let the land without the lessor's written consent.

4.1 The lessor must not unreasonably withhold its consent to a transfer of this lease or a sub-lease of the land if the lessee has complied with the conditions in clause 5.2.

4.2 To obtain the lessor's consent to a transfer or sub-lease the lessee must:-

(a) Ask the lessor in writing to consent to the transfer or sub-lease;

(b) Give the lessor –

(i) In relation to each proposed new lessee or sub-lessee, its name and address, two written references as to its financial circumstances and two written references as to its farm management experience; and

(ii) A copy of the proposed document of transfer or sub-lease.

4.3 The new lessee or sub-lessee and the directors of them if they are a corporation must execute a deed binding each of them to carry out the obligations of the lessee under this lease and a guarantee and indemnity.

4.4 The lessee must pay the lessor's reasonable expenses incurred in connection with the application for consent or the granting of consent and the completion of the documents.

4.5 The lessee must not give up possession or share occupancy of the land or grant a licence to anyone else without the lessor's written consent which may be given or withheld in the lessor's discretion.

4.6 The obligations to the lessor of every lessee who has transferred this lease continue until the lease ends.

5. LESSOR'S OBLIGATIONS

5. The lessor must give the lessee quiet possession of the land without any interruption by the lessor or anyone connected with the lessor as long as the lessee does what it must do under this lease.

5.1 The lessor must, at its own expense, obtain the written consent of this lease of all relevant mortgagees or debenture holders.

6. INSURANCE

6. The lessee must take out and keep current insurance in the names of the lessee and the lessor for public risk for the amount of $10 million with an extension which includes the indemnities given by the lessee to the lessor.

6.1 The lessee must produce satisfactory evidence of insurance cover on written request by the lessor.

7. GENERAL AGREEMENTS BETWEEN LESSOR and LESSEE

7. When the terms ends the lessee must:-

(a) Return possession of the land to the lessor; and

(b) Remove the lessee's installations and other property from the land and make good any damage caused in removing it.

7.1 If the lessee leaves any of its installations or other property on the land after the end of the lease, unless the lessor and lessee agree otherwise, that property will be considered abandoned and will become the property of the lessor.

7.2 The lessee indemnifies the lessor against any liabilities arising from the use of the land by the lessee except to the extent that the liability is caused by the negligent act or omission by the lessor or its servants or agents.

7.3 The lessee:-

(a) Uses and occupies the land at its own risk;

(b) Releases the lessor from all liabilities arising from events occurring on the land or from any omission on the part of the lessee or its servants or agents except in those cases where the liability is caused by the lessor or a person for whom the lessor is responsible.

8. EVENTS OF DEFAULT and LESSOR'S RIGHTS

8. The lessor may re-enter the land and end this lease if:-

(a) The lessee does not pay the rent for 14 days although no demand has previously been made for it by the lessor;

(b) The lessee does not meet its obligations under this lease;

(c) The lessee being an individual -

(i) becomes bankrupt;

(ii) takes or tries to take advantage of part 10 of the Bankruptcy Act;

(iii) makes an assignment for the benefit of his or her creditors; or

(iv) is unable to pay his or her debts when they fall due.

(d) The lessee being a corporation -

(i) has an order made or a resolution passed to wind it up except for reconstruction or amalgamation;

(ii) goes into liquidation;

(iii) is placed under official management;

(iv) has a receiver, including a provisional receiver, or receiver and manager of any of its assets, or an administrator appointed;

(v) has an inspector appointed under the Australian Securities Commission Act; or

(vi) without the lessor's written consent, there is a different person in effective control of the lessee as a result of changes in -

(vii) membership of the company or its holding company;

(viii) beneficial ownership of the shares in the company or its holding company; or

(ix) beneficial ownership of the business or assets of the company.

8.1 Re-entry by the lessor ends this lease but the lessor retains the right to sue the lessee for unpaid money or for damages for breaches of its obligations under this lease.

8.2 For the purpose of Section 146(1) of the Property Law Act 1958, 14 days is fixed as the period within which the lessee must remedy a breach capable of remedy and make reasonable compensation in money.

8.3 Breach by the lessee of any of the following clauses of this lease is breach of any essential term:-

2(a), 2(j), 2.1(a), 4, 4.2(a), 4.2(b), 6 and 7.

8.4 Even though the lessor does not exercise its rights under this lease on one occasion, it may do so on the later occasion.

9. OVERHOLDING

9. If the lessee continues to occupy the land after the end of the lease with the consent of the lessor, it will do so as a lessee from month to month and the terms of this lease will apply to the tenancy as far as they may be applicable.

9.1 Either party may end the tenancy by giving one month’s written notice to the other at any time.

10. FURTHER TERM

10. The lessor must renew this lease for the further term or terms stated in item 9 of the Schedule if:-

(a) There is not an un-remedied breach of this lease by the lessee of which the lessor has given the lessee written notice.

(b) The lessee has not persistently committed breaches of this lease of which the lessor has given written notice during the term.

(c) The lessee has requested the renewal in writing not more than 6 months and not less than 3 months before the end of the term.

10.1 The renewed lease:-

(a) Starts on the day after this lease ends.

(b) Has a starting rent determined in accordance with clause 11.

(c) Must contain the same terms as this lease but with no option for renewal after the last option for a further term stated in item 9 of the schedule has been exercised.

11. RENT REVIEW

11. If the lessee exercises the option for a further term contained in clause 10 the rent for the further term will be as agreed between the lessor and the lessee.

11.1 If there is no agreement between the lessor and the lessee as to the rent then the rent will be determined by a valuer appointed by the lessor and the lessee or in the absence of an agreement between them as to the valuer by a valuer experienced in rural valuations nominated by the president for the time being of the Real Estate Institute of Victoria at the request of either party.

11.2 In determining the current market rent for the land the valuer must:-

(a) Consider any written submissions made by the parties within 21 days of them being informed of the valuer's appointment.

(b) Determine the market rent as an expert.

(c) Assume that the land is available to be leased on the same conditions as those contained in this lease including any options for renewal but with a lessee in possession.

(d) Take into account the conditions of this lease including the permitted use.

(e) Ignore the lessee's installations and all improvements made by the lessee to the land without obligation to do so.

(f) Take into account current market rents for comparable land in the locality.

11.3 The rent for the further term must not be less than the rent paid in the previous term.

12. GST

12. For the purposes of this lease:-

G*ST* means	any tax imposed by authority of any GST Law and includes GST within the meaning of a GST Act.
GST Act means	the A New Tax System (Goods and Services Tax) Act 1999 (as amended).
GST Law means	GST law as defined if the GST Act and includes any Act of Parliament of Australia that imposes or deals with GST.

12.1 Except where express provision is made to the contrary, and subject to this clause 12.1, all amounts or other consideration payable by any party under this lease represent the value of any taxable supply for which payment is to be made.

12.2 Subject to clause 12.4, if a party makes a taxable supply in connection with this lease for a consideration which, under clause 12.1, represents its value then the recipient the taxable supply must also pay at the same time, and in the same manner as the value is otherwise payable, the amount of any GST payable in respect of the taxable supply.

12.3 If this lease requires the lessee to pay or contribute to an amount paid or payable by the Lessor in respect of an acquisition from a third party for which the lessor is entitled to claim an input tax credit, the amount required to be paid or contributed by the lessee will be the value of the acquisition by the lessor plus, if the lessor's recovery from the lessee is a taxable supply, any GST payable under clause 12.2.

12.4 A party's right to payment under clause 12.2 is subject to a valid tax invoice being delivered to the recipient.

13. NOTICES

13. A notice given under this lease may be given by post, facsimile or delivery to the other party's last known address or registered office.

13.1 Notices delivered by post will be taken to have been received 72 hours after posting unless proved otherwise.

13.2 A notice delivered or sent by facsimile will be taken to have been received on the next business day at the place where it is received.

14. ADDITIONAL PROVISIONS

14. Any additional provisions set out in Item 11 of the Schedule will bind both parties.

14.1 This lease contains the whole agreement between the parties. Neither party is entitled to rely on any warranty or statement in relation to:-

(a) the conditions on which the lease has been agreed.

(b) the provisions of the lease.

(c) the quality or area of the land and the buildings and improvements.

(d) the suitability of the land for the permitted use.

14.2 The lessee acknowledges that:-

(a) the condition of the land, the improvements on the land and the Lessor’s installations at the commencement of the lease is as set out in the Condition Report delivered to the Lessee prior to the commencement of the lease (called “the condition report”).

(b) there were no promises, representations, warranties or undertakings whether oral or written given by or on behalf of the lessors in respect of the suitability of the land for the permitted use.

15. DISPUTE RESOLUTION

15. The parties must attempt to resolve any dispute by the mediation procedure, except disputes about:

(a) un-paid rent and interest charged on it

(b) review of rent

(c) a dispute to be resolved in another way prescribed by any other provision of this lease.

15.1 The mediation procedure is:

(a) a party may start mediation by serving a mediation notice on the other party.

(b) the notice must state that a dispute has arisen and identify what the dispute is.

(c) the parties must jointly request appointment of a mediator. If the parties fail to agree on the appointment within 7 days of service of the mediation notice, either party may apply to the President of the Law Institute of Victoria or the nominee of the President to appoint a mediator.

(d) once the mediator has accepted the appointment the parties must comply with the mediator's instructions.

(e) if the dispute is not resolved within 30 days of the appointment of the mediator, or any other period agreed by the parties in writing, the mediation ceases.

(f) the mediator may fix the charges for the mediation which must be paid equally by the parties.

(g) if the dispute is settled, all parties must sign the terms of agreement and these terms are binding on the parties.

(h) the mediation is confidential and –

(i) statements made by the mediator or the parties, and

(ii) discussions between the participants to the mediation, before after or during the mediation, cannot be used in any legal proceedings.

(i) it must be a term of the engagement of the mediator that the parties release the mediator from any court proceedings relating to the lease or the mediation.

(j) the mediator is not bound by the rules of natural justice and may discuss the dispute with a party in the absence of any other party.

16. GUARANTEE

16.1 The guarantor in consideration of the landlord having entered into this lease at the guarantor's request -

(a) guarantees that the tenant will perform all its obligations under this lease for the term and any renewed term and during any period of over-holding after the end of the term of the lease, and

(b) must pay on demand any amount which the landlord is entitled to recover from the tenant under this lease, and

(c) indemnifies the landlord against all loss resulting from the tenant's failure to perform its obligations under it or from this lease being or becoming unenforceable against the tenant.

16.2 The liability of the guarantor will not be affected by:-

(a) the grant to the tenant, the guarantor or any other person of any time, waiver or other indulgence or concession or any whole or partial discharge or release of the tenant, the guarantor or any other person;

(b) any transaction or arrangement that may take place between the landlord and the tenant, the guarantor or any other person;

(c) the liquidation of the tenant, the guarantor or any other person;

(d) the fact that the landlord or any other person takes or fails to take any other guarantee or security from any person;

(e) the fact that the landlord or any other person exercises or refrains from exercising any other guarantee or security or any of the rights, powers or remedies conferred on it by law or by any agreement, or fails to recover, by exercise of any such rights, any moneys owing to the landlord by the tenant;

(f) the variation (including a variation which increased the guaranteed moneys or the tenant's obligations), replacement, extinguishment, loss, release, discharge, abandonment or transfer ("change") either in whole or in part of any agreement or document relating to the tenant's obligations including any other guarantee or security now or in the future held by the landlord from any person;

(g) the tenant's obligations or the guarantor's obligations or the obligations of any other person under any agreement or document relating to the tenant's obligations or the guarantor's obligations, including any other guarantee or security, ceasing or being or becoming wholly or partially illegal, void, voidable or unenforceable;

(h) the failure by the landlord to give notice to the guarantor of any default by the tenant or any other person;

(i) any legal limitation, disability, incapacity or other circumstance related to the guarantor, the tenant or any other person;

(j) the fact that any person who was intended to be bound as a Guarantor or surety in respect of the tenant's obligations does not become bound or, having done so, ceases to be so bound;

(k) any laches, acquiescence, delay, acts, omissions or mistake on the part of, or suffered by the landlord or any other person, in relation to this deed or any other guarantee, security interest, agreement or negotiable instrument;

(l) the landlord becoming a party to any compromise or scheme or assignment of property by or relating to the tenant or the guarantor or the acceptance by the landlord of any dividend or sum of money under any compromise, scheme or assignment;

(m) any judgment or rights which the landlord may have or exercise against the tenant, the guarantor or any other person;

(n) if the tenant or the guarantor is a member of any partnership, any change in the membership of that partnership;

(o) if the guarantor or the tenant is a trustee, any breach of trust or any variation of the terms or determination or the trust.

(p) the landlord agreeing to any assignment by the tenant for the benefit of creditors or to any scheme of arrangement or deed or composition under the Corporations Law or the Bankruptcy Act;

(q) the landlord accepting a repudiation of the lease by the tenant and the guarantee given under this deed extends to any amounts payable by the tenant as damages or otherwise and whether payable under the lease or under any action taken by the landlord;

(r) any rights, claims or actions which the tenant may have against the landlord;

(s) any act or omission of the landlord, whether in relation to the lease or otherwise, which but for this paragraph would have the effect of releasing the guarantor;

(t) any judgment, finding or decision by a court, arbitrator or other person in favour of the tenant; or

(u) any transfer or variation of this lease, but if this lease is transferred the guarantor's obligations, other than those which have already arisen, end when the term ends and do not continue into a term renewed by a new tenant nor a period over-holding.

(v) the failure of any guarantor to sign this document.

16.3 The guarantor agrees that:

(a) the landlord may retain all money received including dividends from the tenant's bankrupt estate, and need allow the guarantor a reductions in its liability under this guarantee only to the extent of the amount received, and

(b) the guarantor must not seek or to recover money from the tenant to reimburse the guarantor for payments made to the landlord until the landlord has been paid in full, and

(c) the guarantor must not prove in the bankruptcy or winding up of the tenant for any amount which the landlord has demanded from the guarantor, and

(d) the guarantor must pay the landlord all money which the landlord refunds to the tenant's liquidator or trustee in bankruptcy as preferential payments received from the tenant.

16.4 If any of the tenant's obligations are unenforceable against the tenant, then this clause is to operate as a separate indemnity and the guarantor indemnifies the landlord against all loss resulting from the landlord's inability to enforce performance of those obligations. The guarantor must pay the landlord the amount of the loss resulting from the unenforceability.

16.5 If there is more than one guarantor, this guarantee binds them jointly and each of them individually.

16.6 The landlord may assign or transfer all or any part of its rights or obligations

under this deed without the consent of the guarantor. The landlord must give the guarantor notice of any assignment or transfer as soon as practicable but the failure of the landlord to give any notice does not affect or discharge any of the guarantor's obligations.

16.7 The landlord's determination of any calculation for the purpose of this guarantee (including, without limitation of amounts owing by the guarantor) will be conclusive in the absence of manifest error. The landlord must provide a certificate to the guarantor showing the landlord's calculation and including relevant data or information used in making the calculation.

SCHEDULE

- Item 1 **Lessor**
  [1]
- Item 2 **Lessee**
  [1]
- Item 3 **Land**
  [1]
- Item 4 **Rent**
  [1]
- Item 5 **Payment of Rent**
  [2(a)]
- Item 6 **Term**
  [1]
- Item 7 **Lessor's installations**
  [1.1]
- Item 8 **Use of Land**
  [2.1(b)]
- Item 9 **Further Term**
  [10]
- Item 10 **Guarantor**
  [1.1]
- Item 11 **Further provisions**
  [14]

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