New Entrants to Farming

Joint Venture Farming

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Joint Venture Options

Land purchase represents a substantial barrier to entry for aspiring and expanding farmers alike due to its high asset value, and its value relative to its income potential. Separating or partially separating the role of landowner and 'operator' can help reduce this barrier.

Formal tenancy agreements have traditionally been the most likely mechanism to facilitate this approach. However, there is growing interest in other more flexible agreements. A joint venture is an umbrella term that covers a wide spectrum of collaborative agreements, including those featured in this booklet, namely:-

- Contract Farming
- Share Farming
- Business equity partnerships

An Introduction to Joint Ventures

A Joint Venture can be considered as some form of co-operation, formed in a legal manner, between two or more parties to form a business relationship, other than as landlord and tenant. There are various benefits and reasons for their creation, including shared risk or improved return on capital through combined resources and expertise to accelerate growth. They can also avoid the need to create a formal farm tenancy.

Examples of common circumstances in which joint ventures can be beneficial include:-

- Land coming back in-hand after being let out. The owner may be inexperienced but wishes to retain vacant possession.
- The farm may not be large enough to be a viable holding on its own.
- The farmer may wish to release equity.
- To obtain economies of scale through splitting the cost of farming with others.
- The business may be in need of large capital investment.
- The owner may want to retire, not having a natural successor, but not ready to sell.
- There may be a substantial tax advantage.

What they are not…

Genuine joint venture agreements work well but must be more than a written document. In practice, it is important for both parties to abide by the governing rules in order to retain the advantages (including tax benefits) and avoid it construed as an alternative legal entity such as a tenancy, partnership, or employer/employee relationship.

Note that each agreement will be different.

SAC Consulting prepared this factsheet to provide general guidance. This does not substitute the need for specialist and tailored advice or a professional agreement.

If you are thinking of undertaking a joint venture, speak to your solicitor and accountant to discuss tax implications. A consultant or land agent can then help establish required legal documents for all parties to agree and sign.

Contract Farming

A standard Contract Farming Agreement (CFA) is the terms of understanding between two parties. That is, a landowner / occupier (known as the “farmer”) who has engaged the services of another (known as the “contractor”) to undertake farming operations over a fixed period (typically 3 to 5 years) on pre-arranged terms – it may be more simply understood as farming with contractors.

Obligations:

The farmer normally provides the land, buildings, fixed equipment (if required or agreed), a dedicated bank account, pay the required bills, finance to administer the agreement, and any farm knowledge. For this, they will receive what is commonly termed a basic retention/fee. This is agreed with the contractor in advance of the start of the agreement.

The contractor provides the labour, machinery (including its incurred costs) and management expertise. The contractor could be a neighbouring farmer, large farming company or traditional contractor. For this, they receive a basic contractor’s fee (usually quarterly or half-yearly).

Via a separate livestock hire agreement, either party can supply breeding livestock (if applicable). Both parties agree farming policy and the share of any divisible surplus in advance and meet regularly to make management decisions and monitor progress.

The mechanics of a CFA:

1. Agree a land “retention” and “contractors fee”
2. There are three bank accounts (no. 1 farmers a/c; no.2 CFA a/c; no3. Contractors a/c)
3. The Farmer establishes a No.2 a/c to be distinct from any other of their activities
4. Dwelling accommodation or industrial buildings are excluded from the agreement but may be available by separate negotiation with a residential or commercial lease

An example of how the three accounts work is shown below:

	No.2 A/C	**Farmer Income**	**Contractor Income**
Sales	£80,000		
Variable Costs	-£30,000		
Fixed Costs	-£5,000		
Contractors Basic Fee	**-£15,000**		**£15,000**
Farmers Retention	**-£10,000**	**£10,000**	
Divisible Surplus	***£20,000***		
Contractors Share (70%)	*£14,000*		*£14,000*
Farmers Share (30%)	*£6,000*	*£6,000*	
TOTALS	**£0**	**£16,000**	**£29,000**

Benefits to the farmer:

A properly constructed CFA can avoid creation of a tenancy and maintains the 'farmer' status for subsidy and tax purposes. It is a very flexible and adaptable agreement. It can generate a reasonably stable income through a basic fee / retention and avoid much of the reoccurring capital and maintenance cost of machinery. It may also avoid the need to employ staff, reducing day-to-day involvement compared with an in-hand farm.

Disadvantages for the farmer:

Maintenance of "farmer" status demands some time involvement in the venture and the farmer must retain some risk. The farmer incurs the administration costs, for example, to manage the agreement and prepare separate financial accounts. For simplicity, a contract ('No2') account is preferable for associated sales and input costs, although it is not essential. The No2 account is not a separate business so the farmer will need to reclaim any VAT and transfer back to the account.

Benefits to the contractor:

Contractors can benefit from economies of scale (spreading fixed costs) by taking on more land without tying up capital through land purchase or full duplication of machinery. This makes it a relatively quick way to expand. There is a guaranteed regular payment per hectare (or per animal) through a contracting charge, with an incentive to maximise the financial surplus.

Disadvantages for the contractor:

Despite having the flexibility of rolling from one agreement to the next, CFA's do not provide long-term guarantee, which can make longer-term planning difficult. There can be a higher administration fee for budgets and accounts. It does also rely on both parties getting on well together. While a CFA can provide economies of scale it may be difficult to build capital.

How to make it work:

The biggest factors in a successful arrangement are:

1. Trust, honesty and pragmatism
2. Robust terms
3. Good incentives for the contractor to concentrate their efforts (this will also reward the farmer through a share of a higher divisible surplus).
4. Third party involvement to set up the agreement

Consideration should be given to profit sensitivity to market price, technical performance and weather impacts since the agreement also needs to work in more challenging times. Agreement clauses cannot safeguard against every eventuality, but a concise agreement will help structure important but easily omitted issues such as mutual responsibilities for cross-compliance, health and safety and associated insurance.

The "farmer's" overall return under a CFA can be comparable or better than under an in-hand farming operation as significant capital is released from investment in machinery etc. (enabling invested elsewhere). A Contractors costs are invariably also less than the farms existing overheads due to economies of scale.

Share Farming

Share farming is an arrangement between two independent businesses. It is often confused with contract farming but there are some differences, for example:

1. These are two entirely separate businesses working the same land.
2. As separate businesses they share the value of the farms output (typically sales) rather than a fee plus share of net profit.

There is no standard share farming agreement. The details are a matter for the parties involved but each party needs to bring complimentary resources and skill sets. The share farming structure is not as popular as contract farming in the UK but it is commonplace in New Zealand. It is possible to start as a share farmer with only a small share then progressively build equity share (within the terms of the agreement) until owning most or all of the stock and/or equipment. There are three conceivable paths for the agreement:

1. It may be a step towards farm succession.
2. If agreed, share farmer equity in livestock could be increased on renewal of the agreement.
3. Terminate the agreement:
    a. allowing the share owner to follow an alternative plan.
    b. to allow the share farmer to buy into another or larger farm.
    c. liquidate to enable the share farmer to purchase their own farm and likely become a share owner.

Obligations:

Typically, the share owner / occupier provides the land, buildings, fixed equipment, fixed machinery, major maintenance of buildings and expertise along with paying a certain percentage of certain input costs. The share farmer / operator will provide the working machinery, moveable equipment, and technical ability and pay the balancing cost of inputs. Livestock are usually held in undivided shares. Output and certain input costs (direct costs) are split using pre-agreed allocations.

Benefits to the share owner:

Share farming can be a useful mechanism to release capital from machinery and livestock to focus on alternative investments. It is also useful if wanting to retain management involvement without the day-to-day operational role. It is a tax efficient method provided ‘farmer status’ is maintained. Such agreements can also facilitate the owner to retire gradually, while profitability could improve through tapping into the drive and skill set of the right share farmer. Share farming can allow for a new enterprise to be introduced to the farm, of which the owner may not have expertise in.

Disadvantages for the share owner:

The length of any agreement may be limited if the share farmer has the opportunity to move to a larger farm business – although exit clauses can be defined in the contract agreement. While performance might improve, volatile markets and profit margins mean operators will need to be top performers to achieve adequate returns for each party.

Benefits to the share farmer:

It presents an opportunity for significant involvement in a farm business for someone with the necessary skills, but limited capital. Share farmer assets are transferable and can therefore move if a greater opportunity presents itself.

While it has proven successful for new entrants in New Zealand the success of the share farmer to accumulate sufficient funds to achieve any of the above aspirations (previous page) largely depend on profitability, commodity prices, breeding stock value and land markets.

Disadvantages for the share farmer:

There are few share farming opportunities in the UK, therefore, progression beyond the existing agreement could be limited – this is most likely to progress to a larger contract farming agreement or equity partnership in the UK. Within share farming agreement, the owner often remains in the farm house, resulting in no house being available for the share farmer.

How to make it work

There needs to be a clear understanding of why both parties are entering into an agreement. Clear and honest discussion is required to frame expectations. This should also cover the philosophy to farming policy. For this reason, many agreements work best between parties that had a prior relationship.

In addition to technical ability, there needs to be comfort in the knowledge that a prospective share farmer has the management potential to move from potentially being an employee to business owner status – requiring a different skill set.

As with a contract farming agreement, careful construction of the agreement is necessary to ensure, as far as possible, each party has a reward relative to their involvement (responsibilities / time / skills / equity / risk). Careful consideration is also required to deal with, for example: issues of responsibility; terms and timing of payment of shared costs; or stock and machinery payout upon termination of the agreement. Sensitivity analysis on budgeted figures is imperative.

Having a written share farming agreement alone is not sufficient evidence of a proper share farming arrangement being in place. Care should be exercised to ensure that the arrangement is implemented in practice, and on examination, cannot be construed as some other legal structure or relationship. Genuine share farming by contractual agreement is not a tenancy and consequently avoids the associated rights and obligations governed by legislation. Neither is it a partnership or employer/employee relationship and therefore avoids any potential liability associated with a share farmer's debts or employment law respectively.

Equity Partnerships

An equity partnership is an alternative way to invest in farming for those who are unable to finance a farm tenancy or ownership as an individual. It can also be an opportunity for outside investors and for existing farmers to grow their business. An equity partnership may also benefit those wanting to release capital from land for alternative investments or allow partial retirement as part of structured succession, particularly with non-family members.

An equity partnership is most likely formed as a company, with potentially multiple investors. These shareholders will pool their capital (equity), and possibly skills or resources, in the aim of generating higher investment growth. The company will identify and assess an investment option, purchase the land, livestock plus necessary machinery and plant. This is funded through shareholder equity and bank debt, borrowed by the company.

There are various structures and the most appropriate will depend on the type of investor. Often one of the partners is employed as the farm manager, known as an equity manager. The board of directors will run governance. Each partner normally appoints one director to the board. This works well provided directors have the necessary and complimentary skills. This responsibility or process can be contracted out, particularly where investor(s) are time limited, remote from the operation or opt to be a ‘sleeping partner’.

Benefits of an equity partnership:

It is a route to establishing an ownership interest that may otherwise be out of reach. The intention would be that pooling capital and resources results in greater scale and a focused board to encourage faster growth and return on capital. It also spreads risk across multiple partners. The equity partnership provides a transparent share agreement – any financial surplus is shared by each partner and reflects their capital shares held in the company.

Disadvantages for an equity partner:

The biggest factor to success through this mechanism is good relationships. Two or more investors increase the risk of disagreement over strategic direction or losing confidence during any period of successively low profits. Decision-making can become bureaucratic and slow. Changes in business or personal objectives of one partner can affect the other(s).

The need for clear understanding:

Each partner needs to have a clear understanding of their role and responsibilities within the partnership and be honest about their motives. A robust process (due diligence) is required to ensure the people you are looking to invest with have similar values, purpose and vision. Regular board meetings are required to aid communication and help drive the business.

Rules of engagement need to be expressed in legal documents. A structure for the partnership needs to be established which is fair to all, tax effective and flexible (including an exit strategy and contingency plan). A sound business plan outlining farm policy, cashflow and capital budget is required, with a robust sensitivity analysis to ensure each partner has realistic expectations and understands their risk exposure – this is best practice for any business including the family farming partnership but this structured process instils focus.