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Sharefarming in the sheep & beef industry

A study of

***SHARE FARMING IN THE
SHEEP AND BEEF
INDUSTRY.***

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Introduction.

One of the major changes seen in New Zealand agriculture in recent years has been the move from family owned and run farms to bigger properties in order to achieve economies of scale. This requires large amounts of capital to purchase and run these farms. Traditionally borrowing has been used as a means to expand and develop properties but the high interest rates of the late 80's combined with low product prices caused many to search for alternatives. Sheep and beef farmers have always referred to themselves as being asset rich and cash flow poor which means servicing debt can become a handicap. Interest is a fixed cost and not an expense that can be deferred or cut back, and was the downfall of many farmers over this period.

In recent years the confidence has returned to the agricultural sector on the back of high product prices and returns to farmers. This combined with competition from the dairy and forestry industries has pushed the price of sheep and beef land to the point where it is now virtually prohibitive for a young farmer wishing to purchase a farm to do so without some form of backing or a fair degree of equity.

The average age of sheep and beef farmers in New Zealand is also increasing with many now reaching the age where they are considering stepping back from the day to day management of the property or retiring completely. Many would like to retain the ownership of the land but would like to release some of the equity they have tied up in their business.

The share milking agreement has been part of the dairy industry for many years now and plays an important role in combining equity and providing a path to farm ownership. The sheep and beef sector has been slow to pick up on this concept. To highlight this it is estimated that one third of all dairy farms in New Zealand employ a share milker where as it is thought that less than 2% of sheep and beef properties involve share farming to any degree.

For this reason it is felt that there is huge potential in the sheep and beef industry for share farming as a means for young farmers who otherwise wouldn't be able to grow their equity through farming and land owners who are looking for an alternative management structure to combine their resources. The resources of the share farmer being stock, plant and enthusiasm and the landowner providing the land. Generally in a share farming agreement the expenses and income are split between the farmer and owner on a predetermined basis. This agreement means that the share farmer can not only have full management control of the farming operation but also be financially rewarded for any increased production they achieve and has the opportunity to increase their equity through the ownership of stock. It allows the farm owner to step back from physically farming the property and by selling their stock and plant they have capital available to retire debt or invest off farm.

Because I feel that more people are going to realise the benefits of equity sharing and

move to some form of share farming agreement I have chosen to do this study on the topic. The aim of the study is to give those considering the idea a brief over view of what is involved, what has already been done and what possibly needs to be considered before entering into such an agreement. The study is comprised of the result of interviews carried out with those who have experience this this area. As I found out during these interviews, there is no right or wrong way to go about forming a share farming agreement. All of the agreements I looked varied to some extent as those involved had made adjustments to suit their individual needs.

Reasons for going share farming.

All of the share farmers I spoke to shared many of the same attributes and attitudes. On the whole they were young (late 20s-early 30s). They all had had experience in managers or stock manager's positions and were keen to progress in the industry. Interestingly, unlike the dairy industry, farm ownership wasn't a strong desire amongst all I talked to. Many of them felt that buying a farm was still beyond them and that the return that they were receiving on their capital was far superior to what they might be achieving if they owned land. The most common goal was to lease property.

They were all extremely motivated and ambitious and had a strong desire to work for themselves. A recurring theme was that they gained real satisfaction from putting in a 'hard days work' with the knowledge that the rewards would come to them.

Generally those who go share farming only have a limited amount of capital. This is usually in the form of money saved from wages or in the form of stock. This limited capital is preventing them from going in to farm ownership or leasing a property and they see share farming as a vehicle to increasing their equity. They felt that owning livestock and being able to increase both the numbers and quality of stock run enabled them to do this. It was also an area they felt comfortable to be involved in financially as it was where they considered their expertise to lie.

There were also a couple of examples where the share farmer was a younger family member who had returned to the family farm. Share farming was seen in these instances as the best way to get the son, in these cases, established. Reasons given for this is that it didn't require the same capital input as leasing might.

Reasons for employing a share farmer.

The reasons for the landowners heading down the share farming track were quite varied in the examples that I looked at. In most cases the farmer was reaching retirement age and there was no likelihood of a son or daughter returning to the property in the near future. These people, although keen to step down from hands on management, listed retaining ownership of the property as a high priority. They also felt that share farming allowed them to retain an involvement in the running of the property that leasing wouldn't allow. The amount of involvement that the landowners had varied hugely from agreement to agreement. I came to the conclusion that it is really something that comes down to the individuals involved to sort out amongst themselves. It is important though that this is established from the outset.

Share farming also gives a landowner the opportunity to release capital currently tied up in stock and plant. Reasons for doing this included financing the land owners retirement, financing further development of the property and reducing debt.

Another interesting example of where a share farmer had been employed was where an existing farmer had purchased an additional property and preferred to have somebody running it with a financial stake in the operation rather than a manager on wages. The land owner realised that the return on capital might not be so high with this arrangement but was prepared to accept this knowing that a share farmer is likely to be more conscientious and stay on the property longer than a manger might.

What is deemed to be necessary in order for a share farming agreement to succeed.

* The first of these is undoubtedly a good relationship between the share farmer and the landowner. It can be a huge leap of faith for a farmer to allow an outsider to invest and become so closely involved in their farming operation. Both parties need to be very clear as to what is expected of them and what their responsibilities are. The majority of share farming agreements have been set up with the help of a contract or agreement guidelines provided by an outside source such as a consultant, but at the end of the day it is important for the two parties to decide how the agreement is to work best for them.

* As part of this good relationship, in every case I have looked at there has had to be a fair degree of flexibility. No two operations or agreements are the same and there are always going to be unforeseen issues that arise and the agreement needs to be flexible enough to cope with these. As an example of this, in one operation I saw the sharefarmer was required to pay 100% of the shearing costs but only received 33% of the wool income which didn't cover his expenses. It became obvious that shearing was a costly exercise for the sharefarmer so with an adjustment to the split for wool income this problem was solved.

* Most people spoken to who have been involved in share farming agree that in order for the agreement to work the property should be a minimum of 7500 stock units. This will vary of course depending on the location, performance and level of development of the property. At the end of the day though two incomes need to be derived from the property, and the agreement is going to struggle to work if there is not enough cash being generated.

* Many of those spoken to felt that some form of independent advisor or supervisor was essential. The role of this person was to oversee the agreement and act as an arbitrator if any disputes were to arise. Those who felt that there wasn't any need for such a person were generally family members or those who had a good working relationship of some sort prior to entering a share farming agreement. Most commonly a farm consultant was used to carry out this role.

* The length of time the agreement was for was something all of those surveyed had strong opinions on. All were unanimous that there needed to be a minimum period at least. Both parties felt that due to the relatively high set up costs of an agreement and the need to be able to plan, they had to enter an agreement with a minimum period in mind. The majority felt that the period of the agreement needed to be discussed prior to entering into it. It was generally felt that a term of 5-7 years was needed to suit both parties. This gave the share farmer time to develop the property and improve genetics to the point where increased returns resulted. It also allowed the farm owner to step back from the operation if they desired safe in the knowledge that they would not be required in a hands on role or have to find another equity partner in the near future.

* A common clause in all the agreements looked at was that a set proportion of gross farm income should be spent on repairs and maintenance. This ranged between 16% and 21% GFI. This was felt to be important for two reasons. Firstly it protected the value of the asset of the land owner, that is the farm. Secondly it ensures that level of production achieved by the share farmer was at least sustainable and preferably improving. Many of the agreements also had similar clauses for fertiliser for exactly the same reasons. One agreement stated that a minimum of \$4/ s.u. had to be spent annually.

Common types of share farming agreements.

From talking to those who are involved in share farming agreements it soon became obvious that there were two main formulas for setting up an agreement. Although the details differed in every case the fundamentals remained the same. Interestingly enough the two forms of the agreement tended to be grouped regionally which suggests a sharing of knowledge through consultants, banks or neighbours.

The most common example is also probably the most straightforward and easiest and cheapest to set up. Put simply the land owner provides the land and buildings and the share farmer provides the stock and plant. This is modelled on the dairy industry where the share milking arrangement has proven so successful. This means that the land owner is responsible for all cost relating to the land and the farmer for costs running costs. A typical schedule for cost allocation is as follows.

Share farmer

- * wages
- * animal health
- * dog expenses
- * supplement feeds and their making
- * shearing and crutching cost
- * farm electricity
- * cartage and spreading of all fertilisers
- * application of all chemicals
- * all vehicle, tractor, machinery and motorbike costs
- * provide the labour for repairs and maintenance
- * insurance on all movable plant

Land owner

- * rates and any rental
- * fertiliser
- * chemicals
- * seed
- * materials for repairs and maintenance
- * insurance on buildings

The cost of all replacement and trading stock is share equally.

In this arrangement the income from all produce is split 50/50. The exception to this being the sale of capital stock where the proceeds most commonly go to the share farmer. In the examples looked at the income was mostly split monthly or bi-monthly. There was one case where it was divided six monthly. From a simplicity point of view this was the least demanding in terms of administration but doesn't match the cash flow requirements of most sheep and beef operations.

The following is an example which illustrates how this agreement might work on a relatively high performing unit.

Physical details.

Area: 600ha.

Stock wintered: Sheep	3000 ewes	
	800 hgts	
	50 rams	3850 s.u.
Cattle	400 r.1 fresian bulls	3200 s.u.
		<u>7050 s.u. or 12s.u./ha.</u>

Policy: ewe replacements kept
remaining lambs finished
ewes culled age 5
bulls finished 18 mths

Performance: 140% lambing
16 kg lamb cwt
5kg wool/hd
270kg bull cwt.

Prices: lambs \$4.00/kgcwt
wool \$3.50/kg
cull ewes \$50 net
bulls \$3.00/kgcwt

Capital: land and buildings (\$5000/ha.)	\$3 000 000
stock and plant	<u>\$ 550 000</u>
	<u>\$3 550 000</u>

Income.

	Share farmer	Land owner
Lambs	108 800	108 800
Wool	33 250	33 250
Ewes	15 000	15 000
Bulls	<u>162 000</u>	<u>162 000</u>
	<u>319 050</u>	<u>319 050</u>

Expenditure.

	Share farmer	Land owner
Stock purchases	120 000	
Wages	5 000	
Animal health	20 000	
Fertiliser		80 000
Electricity	3 500	
Shearing	22 000	
Cartage and spreading	15 000	
Weed and pest		5 000
Vehicle exp	10 000	
Seed		12 000
Repairs and maintenance		17 500
Hay and silage	5 000	
Fuel	8 000	
Insurance	2 000	5 000
Rates		12 000
Administration	2 000	2 000
Drawings	25 000	
	<u>237 500</u>	<u>133 500</u>
Gross surplus.	<u>81 550</u>	<u>185 550</u>
Return on capital.	14%	6%

As the example shows, the return on capital for the share farmer is significantly higher than for the land owner. This shows that a share farmer has the potential to greatly increase their equity in a short period of time. It has to be remembered though that even though the share farmer has a significantly higher return on capital, the landowners equity is in the form of relatively safe assets such as land and buildings. Because of the nature of fluctuating stock prices, the share farmer really needs a higher return in order to offset risk.

The other agreement which is quite common is where the share farmer buys into the existing business. Typically this was in the form of an undivided 33% share of the livestock and a 50% share of the plant. This type of agreement is becoming more common in the dairy industry and is often referred to as equity partnerships. It achieves the same goals as other share farming agreements in that it provides a financial incentive for the share farmer and allows the opportunity for the land owner to free up capital.

The allocation of expenditure is again split so that the share farmer is responsible for those which they have control over while the farm owner pays the fixed costs.

The perceived advantages of this agreement over the previously mentioned one was that both parties share a responsibility for the whole operation rather than just their individual part of which they have a financial stake. It also allows for more flexibility if the incoming sharefarmer is lacking in capital. They can either take a loan from the bank using the landowners remaining equity in stock as security, or if the land owner does not require the capital immediately, a current loan account can be set up with the owner financing the share farmer for their portion of the stock.

Another advantage of this system raised several times was that it meant that the existing stock stayed on the property which meant production was unlikely to suffer with the changing of share farmer.

The main disadvantages highlighted with this type of partnership are similar those mentioned about other forms of share farming. These include the risk of the share farmer buying in at a time when stock prices are high and exiting the agreement when they are low. In this case though the farmer can't take the stock and move to another property to ride the low out. As with other types of agreement it can obstruct the potential sale of the property for the duration of the agreed contract. This type of partnership is also more expensive to set up and more complicated in its management.

Key clauses of a share farming agreement.

The following are the key documents and clauses which were identified to be important for the successful operation of a share farming agreement.

- * Duration of the agreement, minimum notice for termination and provision for extension
- * Share farmers responsibilities
- * Land owners responsibilities
- * Employment of an advisor or neutral party
- * Property area and boundaries
- * List and valuation of land, buildings, plant and stock
- * Minimum and maximum number of stock units to be run
- * Maintenance of current state of the farm
- * Permitted farming policy
- * Procedures for the sale of stock
- * Apportionment of costs and income
- * Minimum and maximum to be spent on R & M and fertiliser
- * Staffing levels
- * Maximum share farmers drawings
- * Performance rewards
- * Disputes and arbitration procedures
- * Confidentiality

Conclusion.

After completing this project I am convinced that share farming has the potential to play a huge role in the sheep and beef industry both now and in the future. As agriculture moves towards an almost corporate style of ownership, share farming gives those entering into sheep and beef farming a foot in the door and a means to progress in the industry in the same way which has proved so successful in the dairy sector for so many years. Share farmers are provided with some very achievable financial goals and targets and can be well rewarded for their efforts and endeavours. It enables land owners a chance to release some of the equity tied up in their operations and provides them with extremely motivated managers who share in the goal to maximise returns from the property.

A share farming agreement can be extremely flexible and altered to suit the situation depending on the wishes of the partners involved. The allocation of costs and income can be altered in favour of the land owner to suit a share farmer who has limited capital. The share farmer can then take more of the costs and receive a higher percentage of the income as their level of equity in the business increases. The key point seems to be to achieve a fair result for both parties and to ensure they are both receiving a satisfactory return on the capital they have invested.

No agreement is going to be successful without a good relationship between the share farmer and the land owner. Trust and confidence in each others abilities are crucial. Going into business with anyone can be fraught with difficulties and share farming is no different. Basic guidelines need to be established from the outset and both parties need to be clear as to what their responsibilities are and what is expected of them. The hazard here is setting too much in concrete so that if further down the track one party feels that they are being disadvantaged, the agreement can't be altered to achieve a fair result.

Sustainability seems to be a key issue with any share farming agreement. When commencing an agreement, existing levels of production need to be able to be at least maintained and ideally improved. This can be done through clauses which establish minimum staffing levels and minimum amounts to be spent on repairs and maintenance and fertiliser. This also has the effect of protecting the land owners asset from becoming run down. Increasing production levels will result in the returns partners receive on their investments should be at least maintained even through a drop in product prices.

As mentioned earlier there is no right or wrong way to go about establishing a share farming agreement. It is up to those involved to assess their current situations and determine how best one might be structured. In compiling this report I have found that those who have been involved in share farming, whether it is as a farmer, land owner or consultant, are only too willing share their experiences, knowledge and information with others.