

Leasing - the Next Option?

I've seen much evolution of ownership and management structures over my consulting career. The latest trend appears to be an increase in land leasing. This seems to be a logical response to changing business, demographic and trading environments. It's driven by a desire by owners to delegate the physical management and trading risk of farming while maintaining exposure to the traditional capital growth and secure (but modest) returns from land ownership.

I see it as a practical way of partitioning the farming investment between stock and plant, dairy company shares and the land itself. It offers a better balance of investment than 50:50 sharemilking as lessees extend their portfolio to include Fonterra shares. It offers autonomy and independence that is not available to a 50:50 share milker or even a managing partner in a joint venture. It releases capital for diversification for the farm owner.

An aging population of landowners and the sizeable equity needed to fund outright purchase of a sustainable farming operation makes this a logical choice.

Risk & Return

It's well recognised that the cash profits from farming come from the stock and plant while capital growth arises from the land and shares. A share milking operation should be targeting returns in excess of 15% on the stock and plant investment. Returns need to be at that levels as sharemilkers bear the risk of climatic and product prices along with exposure to changes in stock values which can see equity added or subtracted at alarming speed.

The current trading environment has implications for both sides of the leasing transaction. Those who wish to exit their farming operation and rationalise back to simple land ownership have an opportunity to capitalise on stronger stock values. Those whose investment is solely in stock and plant may benefit from greater balance through participation in Fonterra shares.

Delegation

Farming profits result from a mix of production, climate and market risk. As land owners age and achieve low or no debt, they may be more interested in certainty of returns than riding the roller coaster of a full farming operation. Lease returns can be as low as 3% to 5% of land value however this may still be sufficient to meet lifestyle and return on capital expectations – especially if the historical trend for growth in values continues.

There is potential to link rentals to product returns. This is usually based on a minimum guaranteed rental complemented by a formula that shares the "super profits" in years of higher milk prices. It offers the land owner the chance to share in industry fortunes and may even eliminate the need for rental reviews.

The Relationship

A good leasing arrangement is more than just about the rental paid. Most important is the requirement to maintain the land or wherever possible add value.

With this in mind, the quality of the relationship and the viability of the lessee's farming operation becomes essential to success. When setting up leases I focus on ensuring there are synergies between the people, their farming systems and business objectives. If the focus is solely on the rental there is a risk that it dominates the

budget and maintenance is overlooked. The lessees business must be profitable for win / win to be achieved.

While it is early days, I expect to see more leasing in the future. Those serious about a farming future and capable of delivering excellence can achieve sound trading returns while also participating in Fonterra as a major slice of New Zealand's economy.

Those wishing to step back from the risk and rigours of a "hands on" farming operation can still enjoy the benefits of capital growth, delegation and opportunity to contribute to a well set up relationship.

When I consider the complexities of joint ventures and the often unreasonable demands made by owners in 50:50 share milking relationships it seems to me this type of structure has potential. Tenant farming has been the solution for other economies. Perhaps its time we took an innovative look at it for our future.

Kerry Ryan is an Agribusiness Consultant, Speaker and Author of "Business Planning for Farmers". You can contact him at www.kerryryan.co.nz