



# Successful Land Leasing in Australia

A Guide for Farmers and their Advisers

A report for the  
Rural Industries Research  
and Development Corporation

by R.G. Ashby

June 2003

RIRDC Publication No 03/080  
RIRDC Project No ASH-1A

© 2002 Rural Industries Research and Development Corporation.  
All rights reserved.

ISBN 0642 58647 0  
ISSN 1440-6845

***Successful Land Leasing in Australia***

*Publication No. 03/080*

*Project No. ASH-1A*

The views expressed and the conclusions reached in this publication are those of the author and not necessarily those of persons consulted. RIRDC shall not be responsible in any way whatsoever to any person who relies in whole or in part on the contents of this report.

This publication is copyright. However, RIRDC encourages wide dissemination of its research, providing the Corporation is clearly acknowledged. For any other enquiries concerning reproduction, contact the Publications Manager on phone 02 6272 3186.

**Researcher Contact Details**

R.G. Ashby & Co Pty Ltd  
Rural Resources Group  
96 Yarra Street  
Geelong Vic 3220

Ph: 03 5224 2663  
Fax: 03 5229 7566  
Email: rga@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 1, AMA House  
42 Macquarie Street  
BARTON ACT 2600  
PO Box 4776  
KINGSTON ACT 2604

Phone: 02 6272 4539  
Fax: 02 6272 5877  
Email: rirdc@rirdc.gov.au.  
Website: <http://www.rirdc.gov.au>

Published in June 2003  
Printed on environmentally friendly paper by Union Offset

## Foreword

The economies of scale of a viable business are often directly related to the return on capital achieved – with bigger businesses tending to achieve higher returns. Nearly half of all farm businesses generate farm cash income of less than a living income. Many of these farm businesses would 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 book 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 report 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 Federal Government.

This report is an addition to RIRDC's diverse range of over 900 research publications. It forms part of our Resilient Agricultural Systems R&D program, which aims to foster the development of agri-industry systems that have sufficient diversity, integration, flexibility and robustness to be resilient enough to respond opportunistically to continued change.

Most of our publications are available for viewing, downloading or purchasing online through our website:

- downloads at [www.rirdc.gov.au/reports/Index.htm](http://www.rirdc.gov.au/reports/Index.htm)
- purchases at [www.rirdc.gov.au/eshop](http://www.rirdc.gov.au/eshop)

### **Simon Hearn**

Managing Director

Rural Industries Research and Development Corporation

## **Acknowledgements**

The author would like to acknowledge the contributions made to this publication by the following individuals:

Content: 30 farmers who provided feedback at a workshop held in Geelong on 10 September 2002.

Presentation: Mrs Frances Yelland, Manager, Rural Resources Group Pty Ltd

Structure and Style: Mr Alan Blackburn, Consultant, Rural Resources Group Pty Ltd

Leasing and Management: Mr Bob Hall, Farm Management Consultant, JRL Hall & Co., Darkan, WA.

Legal Aspects: Mr Alan Williamson, Lawyer, Geelong

Leasing in the UK: Mr C. Cowap, Head of Land and Farm Management Unit, Harper Adams College, UK

Sustainability: Dr J. Walker, Scientist, CSIRO Land and Water, Canberra

## **Disclaimer**

The information in this document does not constitute legal advice and should not be relied upon as such. Specialist advice from lawyers, accountants and other advisers should be sought before acting on any of the information or recommendations contained in this document.

# Contents

Foreword.....	iii
Acknowledgements.....	iv
Disclaimer.....	iv
Contents.....	v
Executive Summary.....	vii

## **Part One: SUSTAINABLE LAND LEASING ..... 1**

1. INTRODUCTION.....	1
1.1 Objectives and methodology.....	1
1.2 Why lease rural land?.....	1
1.3 The availability of land for lease.....	3
2. “Horses for courses”	
– ALTERNATE LAND TENURE PRACTICES IN AUSTRALIA.....	5
2.1 Sharefarming.....	5
2.2 Leasing.....	6
2.3 Other options.....	9
3. LESSONS FROM THE USA AND ENGLAND AND WALES.....	11
3.1 Leasing of rural land in England and Wales.....	11
3.2 Leasing rural land in the USA.....	13
3.3 Lessons from the USA and UK.....	15
4. DEFINING SUSTAINABILITY IN A LEASE SITUATION.....	17
4.1 Background.....	17
4.2 Definitions and principles.....	17
4.3 Indicators.....	19
4.4 Steps in applying sustainability to farm systems.....	24
4.5 Combining sustainability and profitability.....	32
4.6 Marketing sustainability.....	34
5. THE ECONOMICS OF LEASING.....	35
5.1 Farm business performance.....	35
5.2 Evaluating farm leases.....	36
5.3 Leasing values.....	42
6. LEGAL ASPECTS.....	45
6.1 Business structure.....	45
6.2 The lease agreement.....	47
7. BEST PRACTICE IN RURAL LEASING.....	49
7.1 Planning for sustainability and profitability.....	49
7.2 Assessing the lease property – pre lease.....	52
7.3 Leasing checklists for landlord and tenant.....	55
7.4 Ongoing management.....	57

<b>Part Two: A CASE STUDY ON FAIRVIEW .....</b>	<b>59</b>
1. INTRODUCTION .....	60
2. THE CASE STUDY DETAILS.....	60
2.1 The Family .....	60
2.2 The Farm.....	60
2.3 The Business .....	60
2.4 Options.....	61
3. FARM FINANCES.....	61
3.1 Assets and Liabilities .....	61
3.2 Farm Plan for 2002/2003 – no change.....	62
3.4 Cash Budget 2002/2003.....	64
3.4 Discussion and Sustainability Report Card.....	65
4. FARM EXPANSION .....	67
4.1 Options.....	67
4.2 Farm Plan and Budget 2002/03 – Buying or leasing .....	68
4.3 Discussion of Expansion Budgets.....	70
5. LEASING ISSUES .....	71
6. THE FUTURE .....	72
REFERENCES .....	73
APPENDIX 1: Eight key environmental management objectives (VFF) .....	74
APPENDIX 2: ABARE and Farm Monitor Project tables depicting farm business performance, Appendices 2.1 – 2.8. ....	75
Appendix 2.1: Financial performance by industry average per farm, Broadacre farms .....	75
Appendix 2.2: Farm cash income by industry .....	76
Appendix 2.3: Farm Cash Income – Broadacre farms in Australia.....	77
Appendix 2.4: Distribution of farms and value of production, by farm type .....	78
Appendix 2.5: Rates of return, by change in land area classification.....	79
Appendix 2.6: Physical and financial characteristics of farms with contracting, expanding and stable land area, 2000-01 .....	79
Appendix 2.7: Average Farm Profitability: 1970-71 to 2000-01 .....	80
Appendix 2.8: Distribution of Farms by Return on Assets.....	80
APPENDIX 3: Sample Lease .....	81

# Executive Summary

## Aims

- This book 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.
- It provides information on the circumstances under which the leasing of rural land represents an appropriate form of farm expansion. It covers leasing and other land tenure practices in Australia, USA, England and Wales, and defines sustainability in a leased situation. Economics, legal aspects and best practice are also examined. The information is provided together with practical examples, a major case study and several self directed exercises.

## Economies of scale

- The economies of scale of a viable business are often directly related to the return on capital achieved – with bigger businesses tending to achieve higher returns. Nearly 50% of all farm business generate farm cash income of less than \$25,000 pa, an amount which represents less than a living income. Many of these farm businesses would be better off financially by leasing their land and investing some of the income into land improvements.

## Expansion Options

- A farmer who seeks to expand has several options which include share farming, leasing, using contractors or entering into joint ventures with other investors. The risks and rewards associated with each of these options vary and each landowner and farmer needs to assess the suitability of the option to their needs.

## Comparisons with the UK and USA

- Only 6% of all Australian farm land is leased compared with 35% in the UK and up to 50% in the USA. The UK leases tend to be longer on average than Australian leases and the USA leases tend to be much more varied as to type depending on the farm system involved.
- Very little intellectual property has been invested into the leasing of rural land in Australia and hence many leases are short term and do not adequately deal with the complex needs of landowners and tenants and the land itself. Land that is leased is frequently ‘mined’.

## Sustainability

- The definition of sustainability used in this book is the one used by the Standing Committee on Agriculture and Resource Management (SCARM– now the Primary Industries Standing Committee– PISC). This definition takes into account the impact of the farm system on the environment both on and off farm.
- A farm business manager who aims to run the business in a sustainable manner needs to assess the condition and trends in all key resources. The key indicators of the farm condition identified by SCARM are **long term net farm income, natural resource condition, off site impacts, managerial skills and socio-economic impacts.**

- Key attributes need to be identified for each indicator. These natural resource key indicators may vary from region to region and individual farm managers need to identify appropriate indicators for each farm.
- Once a set of key attributes has been identified for each farm a **report card** can be prepared in order to provide an overview of the sustainability of the farm system.

### **Economics**

- The returns from farming are frequently low and extremely variable even in regions which are relatively drought free such as the south west of Victoria.
- A traditional lease generates a guaranteed 5-6% return for the landowner and a variable return to the farmer tenant.
- A participatory lease provides for a base return for each of the landowner and tenant and a sharing of income once a certain threshold has been achieved. Leases of this type are only suitable where there is a high level of trust and understanding between landowner and tenant.

### **Legal**

- It is important that the tenant knows and understands the legal and taxation consequences of entering into a lease and therefore should choose a legal structure which suits their purposes.
- A well structured lease agreement will not only provide details of the landowner, land, tenant and terms of lease, but will also provide details of the landowner's and tenant's obligations under the lease, a dispute resolution clause, provision to assess the condition of the property at the start of the lease, and provisions for managing any specific issues relating to land management.

### **Best Practice**

- Wise landowners and tenants will prepare a business plan to ensure that the conditions of the lease are consistent with the strategic direction of their businesses.
- A condition report will be prepared pre lease and reviewed each year ideally by an independent agricultural consultant.
- Leases should ideally be for periods longer than 3 years and preferably be for 3 x 3 x 3 year terms when lease rates are reviewed at the end of each 3 year term.

# Part One: Sustainable Land Leasing

## 1. INTRODUCTION

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

### 1.1 Objectives and methodology

The **objectives** of this book are:

- 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, USA, England and Wales, whilst Chapter 4 defines sustainability in a leased situation. Chapters 5, 6 and 7 provide information on economics, legal aspects and best practice. The information is provided together with practical examples, a major case study and several self directed exercises.

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

### 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.

Dr Brian Fisher, director of the Australian Bureau of Agricultural and Resource Economics (ABARE) recently pointed out<sup>1</sup> that over the last 40 years the number of commercial farms in

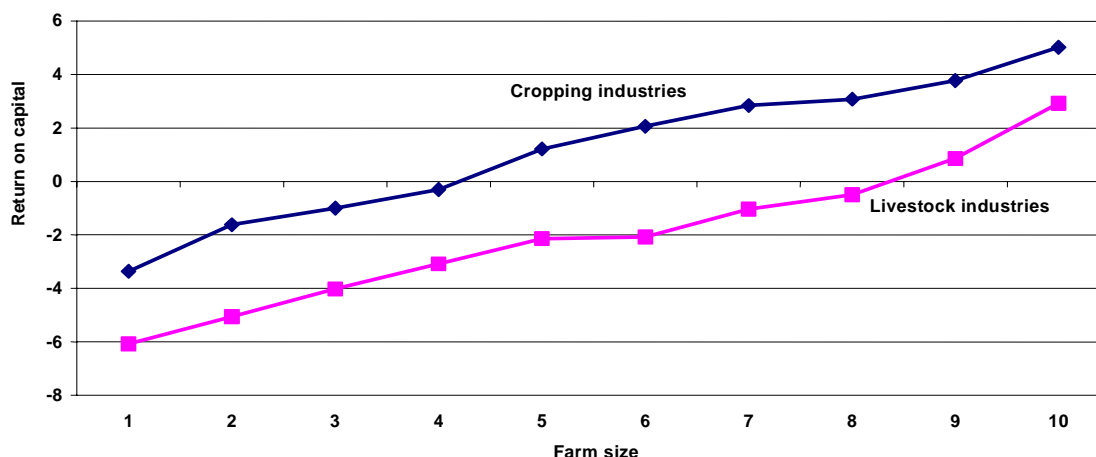
---

<sup>1</sup> Dr B. Fisher's address to the 24<sup>th</sup> Biennial Animal Production Conference.

Australia has halved from about 200,000 to 100,000 whilst the average area of these farms has increased by almost 50% from 2800 hectares to 4100 hectares.

Dr Fisher also pointed out that on average the larger the farm the higher the return on capital (see Figure 1.1). Clearly farm scale is critical to farm profitability.

**Figure 1.1 “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 this increase in average farm size there are still many small farms which made little or no income. In 2000/2001 26% of all farms made no farm cash income (see Table 1.2), whilst another 23% made less than \$25,000. Hence 49% of all broadacre farms made less than a subsistence income in 2000/2001.

**Table 1.2: Farm Cash Income – Broadacre farms in Australia**  
(Source: ABARE Farm Survey 2001)

Farm cash income	1998-99 <i>e</i>	1999-00 <i>p</i>	2000-01 <i>s</i>
Less than -\$25,000	6 %	7 %	10 %
-\$25,000 to 0	20 %	13 %	16 %
0 to \$25,000	29 %	29 %	23 %
\$25,000 to \$50,000	15 %	18 %	16 %
\$50,000 to \$100,000	17 %	14 %	16 %
Greater than \$100,000	14 %	19 %	19 %

*e* Final estimates; *p* Preliminary estimates; *s* Provisional estimates

If a manager’s allowance of \$50,000 is used as a benchmark then only 35% made any 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 – including 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 or helping to 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**

In the case study example if the Jones family leased land from the Browns, the Jones annual cash income increased from \$121,000 to \$133,000 ie. an annual increase of \$12,000 in an average year and much more in a good year.

The Browns were barely making a living before the lease, now they gross \$40,000 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 from 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.

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 along 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.

- Read the case study example to observe the approach to leasing used by the Jones family.
- Can you use the approach made in this case study in order to use land leasing in your business?

## 2. “Horses for courses” – 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.

### 2.1 Sharefarming

A sharefarming agreement is a contract between the land owner and a farmer – usually called the sharefarmer<sup>2</sup>.

“A **sharefarming agreement** may be defined as one in which the owner or lessor of land enters into an agreement with the sharefarmer to work the land on terms that the physical production, gross proceeds or profit derived from the venture is shared between them in agreed proportions.

“The business arrangement of the parties should be stated clearly in the agreement. Usually, the sharefarmer will be granted a licence to assume possession of and work the land for the purposes of the proposed venture.”

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 sharefarming agreement

- The term
- A clear definition of the subject land
- The assets to be provided by each party
  - eg. land and water – landowner
  - machinery, labour, working costs – sharefarmer
- The responsibilities of each party for management
  - eg. landowner – preparing the land to a standard
  - sharefarmer – the production process
  - the marketing process
- Taxation and insurance obligations
- Income and cost sharing arrangements
- Special conditions – Each agreement relates to a particular set of farm conditions and the agreement should provide details to reflect them eg. 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

---

<sup>2</sup> Definition – from Sharefarming and Leasing Agreements – a practical guide, QDPI, 1999.

consistently taken responsibility for a specific area over a number of years. However it is highly desirable that a formal written sharefarming 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 sharefarming agreements**

Most broadacre sharefarming agreements relate to cropping however there is increasing activity in sharefarming 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.

Share dairy farming agreements are usually longer term and are discussed comprehensively in the publication "National Share Dairy Farming Guidebook", Australian Dairy Farmers Federation, 1997.

### **Risks**

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

Different crop sharefarming agreements have significantly different risk profits eg. 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 sharefarming and leasing is provided at the end of this section in Table 2.2.

## **2.2 Leasing**

A leasing agreement is a contract between the landowner and a farmer which gives the farmer the "quiet enjoyment" of the land. A definition of a lease provided by the QDPI is as follows:

**"A lease agreement** is generally a written agreement that enables the lessee (the person leasing the land) to rent land from the lessor (the owner of the land) for a fixed term and use all the resources that the land provides.

"A lease of a property creates a proprietary right of exclusive possession in the person taking the lease ('the lessee') from the owner ('the lessor'). Therefore, it is 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:

- 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 rental and when payable

- The process for rent review
- The landowner's (lessor's or lessee'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 eg. 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 the lessee
- Any guarantees provided

### **Risks**

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 which 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 Table 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.*

<p><b>AFFECT OF DROUGHT ON A TENANT</b></p> <p>In the grazing case study in Table 2.1: Income fell \$22,000; Feed costs increased \$42,000; The budgeted surplus of \$49,000 became a deficit of \$15,000 and Working Capital increased by \$42,000.</p>
--

**Table 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 needed	-	10 DSE/ha @ \$40/DSE = 300ha x 10 = 3000 DSE x \$40/DSE = \$120,000
Working capital	-	The lease costs \$100/ha paid quarterly in advance ie. \$30,000. - \$6,000 of fertiliser must be applied - Including operating costs the farmer estimates that the lease needs in excess of \$30,000 for working capital.
Total average capital needed: Stock		\$120,000
		Working capital <u>30,000</u>
		<b>TOTAL average capital <u>\$150,000</u></b>

The farmer experiences the following outcome in year 1 as a result of the drought. The business experiences poor sheep prices and high feed costs.

**Cash Budget – Year 1**

<b>Income</b>	<b>Budget</b>	<b>Actual</b>	<b>Difference</b>
Wool	\$60,000	\$50,000	- \$10,000
Sheep sales 800	<u>24,000</u>	<u>12,000</u>	- <u>12,000</u>
<b>TOTAL Income</b>	<b><u>\$84,000</u></b>	<b><u>\$62,000</u></b>	- <b><u>\$22,000</u></b>
<b>Payments</b>			
<b>Lease</b>	<b>30,000</b>	<b>30,000</b>	<b>0</b>
Fertiliser	6,000	6,000	0
Sheep costs – shear, crutch, vet,	18,000	18,000	0
– feed	3,000	45,000	- \$42,000
Overhead – interest, travel	<u>5,000</u>	<u>5,000</u>	<u>0</u>
<b>TOTAL Payments</b>	<b><u>\$35,000</u></b>	<b><u>\$77,000</u></b>	- <b><u>\$42,000</u></b>
<b>Margin before management allowance</b>	<b><u>\$49,000</u></b>	<b><u>(\$15,000)</u></b>	<b>(\$64,000)</b>

**Notes:**

- The cash loss incurred needs to be funded and therefore it increases the amount of working capital required.
- Sheep feed 3000 DSE x 20 weeks x 3kgs/hd/wk x \$250/t = 9t/wk x 20 = 180t x \$250/t  
= \$45,000

## **Tax**

A landowner that leases out all land and hence receives rental income, is no longer a primary producer. In effect this means that they cannot **average** rental income and certain expenditure of a capital nature for land degradation 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.

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.

## **2.3 Other options**

In addition to sharefarming and leasing a landowner has other options available if he or she does not wish to manage the land directly themselves.

### **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 eg. 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.

**Table 2.2: Advantages and disadvantages of sharefarming and leasing**

<b>Sharefarming</b>		
<b>Entity</b>	<b>Advantages</b>	<b>Disadvantages</b>
Landowner	<ul style="list-style-type: none"> <li>• Has a say in the use of the land</li> <li>• Reduce need for labour and machinery and hence reduce need for working capital</li> <li>• Capacity to undertake work for which prior capability did not exist</li> <li>• Continues to benefit from any land capital gains</li> </ul>	<ul style="list-style-type: none"> <li>• Is not responsible for the day to day work and the quality of that work</li> </ul>
Sharefarmer	<ul style="list-style-type: none"> <li>• Much less capital needed</li> <li>• Shares the risks of operations</li> </ul>	<ul style="list-style-type: none"> <li>• In a 1 year lease may experience a loss without the chance to recoup it</li> </ul>
<b>Leasing</b>		
Landowner	<ul style="list-style-type: none"> <li>• Fixed income paid at regular intervals</li> <li>• No loss in “bust” years</li> <li>• Minimal working capital required</li> <li>• Capital gain on land still available</li> <li>• Minimal labour required</li> <li>• May retain use of some assets eg. homestead</li> </ul>	<ul style="list-style-type: none"> <li>• No benefit from “boom” years</li> <li>• Loss of primary production status for tax purposes</li> <li>• May not use the land except as determined in the agreement</li> <li>• Land value may be decreased if a sale is needed during the lease term</li> </ul>
Tenant	<ul style="list-style-type: none"> <li>• Less capital required</li> <li>• Land cost fixed for term of lease</li> <li>• Permits the spreading of overhead costs – eg. machinery for cropping</li> <li>• Greater economies of scale</li> <li>• Permits capital to be invested in non-farm costs</li> </ul>	<ul style="list-style-type: none"> <li>• Significant fixed costs which must be met irrespective of farm production and income</li> <li>• Risk of droughts, poor production and poor prices all remain with tenant</li> </ul>

### **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 and draws on materials gathered in 1996 on a study tour of 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 country'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
- 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 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
- 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 solicitors.

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 more recent survey published by RICS on 1 September 1996 found that more farm land is becoming available for tenancies.

These statistics seem to confirm the anecdotal evidence I 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 an ideal combination. 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.

### 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 eg

cropping -	dryland cropping	grazing -	breeding beef cows
	irrigated cropping		fattening beef cattle
	dryland grazing		dairying
	irrigated lucerne		breeding sheep
			fattening sheep

The majority of USA 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 sharefarming 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 sharefarm agreement is provided below from an article by Dr N.L. Dalsted and Paul Gutierrez of Colorado State University.

**Table 3.1: Example of a 50:50 sharefarm agreement for irrigated corn in USA**

Tenant's costs	\$/ac	Landlord's costs	\$/ac
Fertiliser (50%)	40	Seed (100%)	25
Herbicide (50%)	10	Irrigation lease	25
Fuel, oil, lube and repairs	25	Fertiliser (50%)	40
Irrigation energy (50%)	30	Herbicide (50%)	10
Custom combine	22	Irrigation energy (50%)	<u>30</u>
Insecticide	10		
Misc. overhead	<u>13</u>		
	\$150		\$130
	54% of total		46% of total

(Total costs \$280)

Overhead costs are not included in Table 3.1, in this example the landowner provided the land and pays its associated overheads - rates, repairs, insurance and so on. The sharefarmer 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—the three main risks are:

- 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 sharefarmer
3. A percentage of the calf drop is sold by the sharefarmer

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.

My own view is that two major impediments stand in the way of leasing. Firstly many traditional leases have been only short term and frequently 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 raping 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)<sup>3</sup>, which advise 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 4.1)

**Table 4.1: Five principles of sustainability, SCARM, 1998**

- Farm productivity is sustained or enhanced over the long term.
- Adverse impacts on the natural resource base of agricultural and associated ecosystems are ameliorated and minimised.
- Residues resulting from the use of chemicals in agriculture are minimised.
- The net social benefits derived from agriculture are maximised.
- 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 were developed to assist with national policy development.

---

<sup>3</sup> Now the Primary Industries Standing Committee (PISC)

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<sup>4</sup>:

- production skills
- financial skills
- marketing skills
- self and staff management skills
- natural resource management skills

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

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<sup>5</sup> provides a framework which sets out the steps required to ensure the success of a catchment health indicator program (see Table 4.2). 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 4.3 and 4.4). Walker believes that the notion of health indicators is a more useful concept than the less precise one of sustainability.

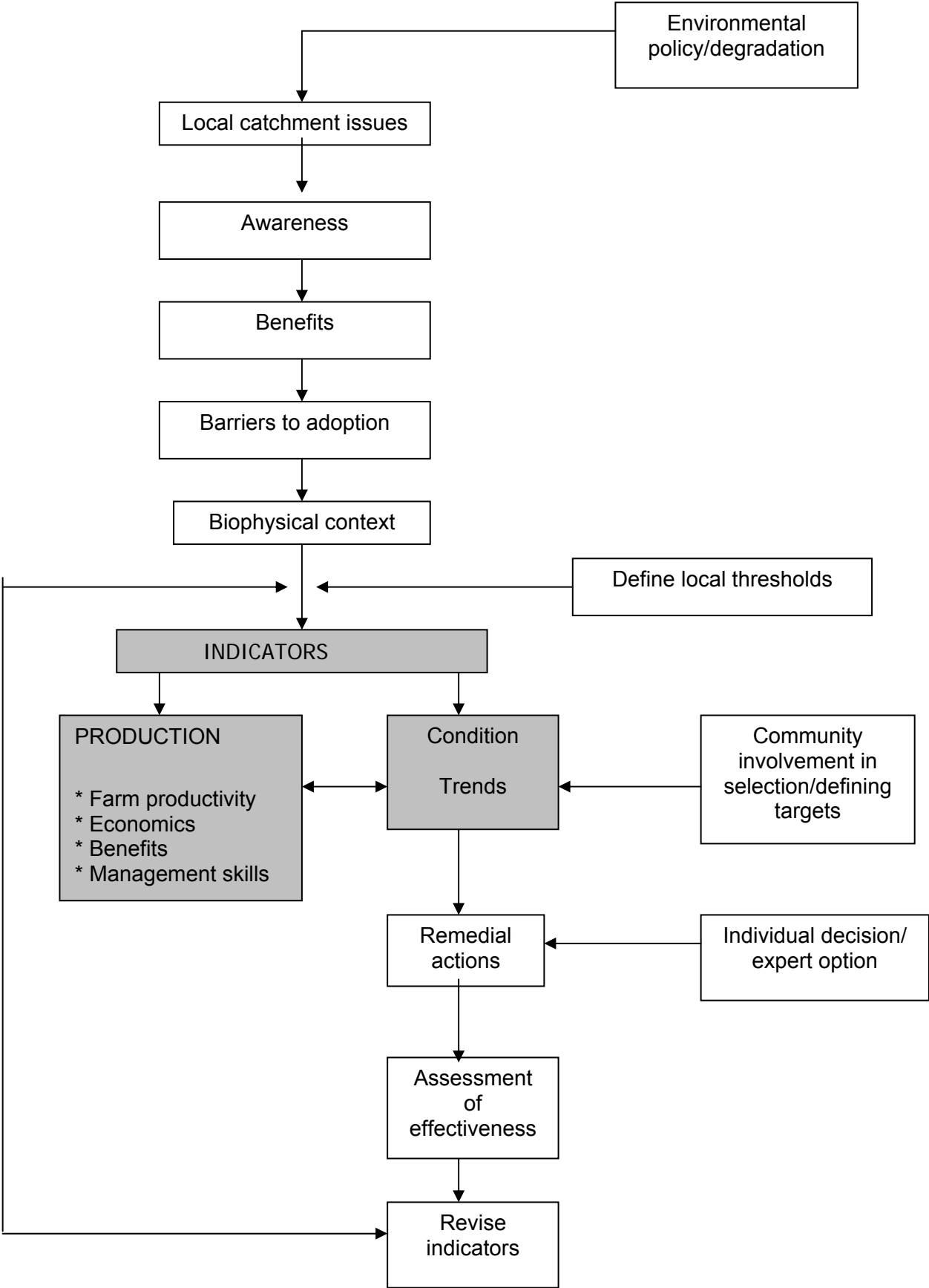
This work by Walker drew on the earlier landmark publication *Indicators of Catchment Health* by Walker, J. and Reuter D.J., published by CSIRO in 1996.

---

<sup>4</sup> Blackburn et al, Farmsmart Resource Manual, pub Rural Resources Group Pty Ltd.

<sup>5</sup> Dr J. Walker, Conditional health indicators as a proxy for sustainable indicators, July 1997, CSIRO.

**Table 4.2: The steps required to ensure success of a catchment health indicator program**



**Table 4.3: Proposed farm and catchment scale health indicators for Australian agro-eco systems**

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

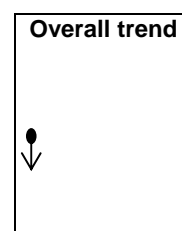
Note: Each farmer can select from the above list the indicators that are relevant to their farm. A few relevant and regularly collected indicators are more important than many irrelevant ones.

**Table 4.4: The Trend Report Card**

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

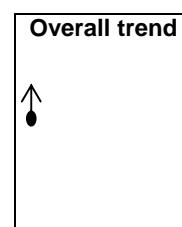
**Trends: Annual pastures**

Indicator	Very good	Good	Fair	Poor	Very poor
Bare soil				●→	
Root depth				●→	
Soil pH			●→		
Soil EC		←●			
Weeds					●→
Stream pH	●→				
Stream EC				●→	
Turbidity		←●			
Macro-invertebrates					←●
Water table depth				←●	



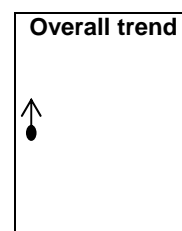
**Trends: Perennial pastures**

Indicator	Very good	Good	Fair	Poor	Very poor
Bare soil			←●		
Root depth		←●			
Soil pH		●→			
Soil EC		←●			
Weeds		←●			
Stream pH	●→				
Stream EC				●→	
Turbidity		←●			
Macro-invertebrates					←●
Water table depth		←	●		



**Farm productivity and product quality (wheat/lucerne pastures/canola)**

Indicator	Excellent	Good	Fair	Poor
% 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 4.5 and 4.6. 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<sup>6</sup> can assist farmers in assessing the condition of the catchment in which they are located. More information on Walker’s work is available at the website [www.affa.gov.au/catcon/](http://www.affa.gov.au/catcon/).

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.

**Table 4.5: The indicators and attributes examined by the National Collaborative Project on indicators for Sustainable Agriculture (SCARM indicators)**

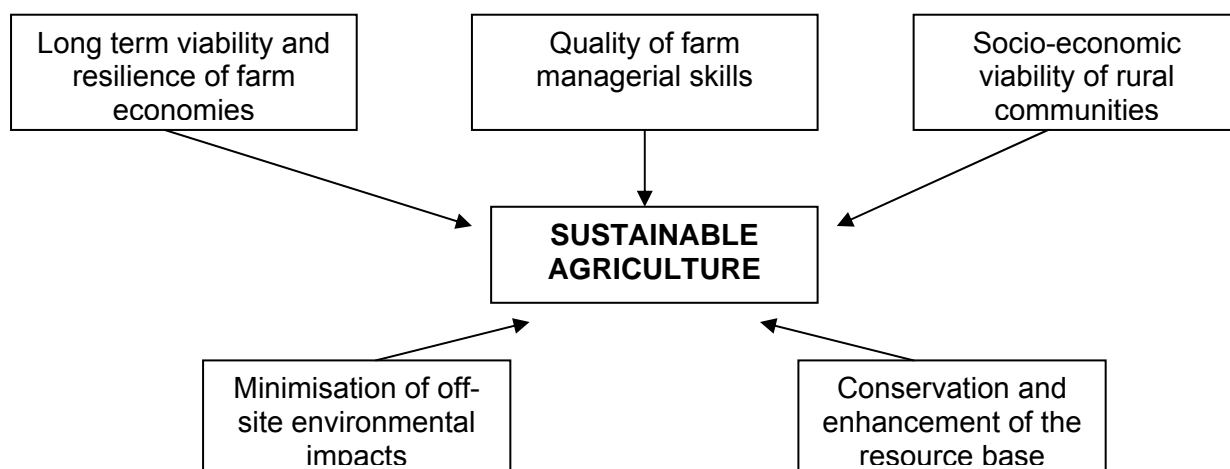
<b>Indicator (Issue)*</b>	<b>Attributes (or measurable indicator)*</b>
Long-term Real Net Farm Income	<ul style="list-style-type: none"> <li>• Real net farm income</li> <li>• Total factor productivity</li> <li>• Farmers’ terms of trade</li> <li>• Average real net farm income</li> <li>• Debt servicing ratio</li> </ul>
Natural Resource Condition	<ul style="list-style-type: none"> <li>• Nutrient balance: P and K</li> <li>• Soil condition: acidity and sodicity</li> <li>• Rangeland condition and trend</li> <li>• Agricultural plant species diversity</li> <li>• Water utilisation by vegetation</li> </ul>
Off-site Environmental Impacts	<ul style="list-style-type: none"> <li>• Chemical residues in products</li> <li>• Salinity in streams</li> <li>• Dust storm index</li> <li>• Impact of agriculture on native vegetation</li> </ul>
Managerial Skills	<ul style="list-style-type: none"> <li>• Level of farmer education</li> <li>• Extent of participation in training and Landcare</li> <li>• Implementation of sustainable practices</li> </ul>
Socio-Economic Impacts	<ul style="list-style-type: none"> <li>• Age structure of the agricultural workforce</li> <li>• Access to key services</li> </ul>

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”.

---

<sup>6</sup> Walker J., Veitch S., Dowling T., Braaten R., Guppy L. and Herron N. “Assessment of Catchment Condition”, CSIRO Land and Water, June 2002.

**Table 4.6: 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<sup>7</sup>. 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 gradings 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 al 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 Table 4.7.

<sup>7</sup> For more information refer:  
 “Indicators of Catchment Health”, CSIRO,  
 “Natural Resource Monitoring Guide”, DNR, Queensland

**Table 4.7: The process of evaluating farm systems for sustainability**

<b>Tasks to be performed</b>	
Step 1	<b>Identify a credible model of indicators and attributes.</b>
Step 2	<b>Analyse the model.</b> This involves analysing the <b>indicators</b> and <b>attributes</b> 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	<b>Revise the model.</b> The key attributes relevant to the selected farm and catchment are identified.
Step 4	<p><b>Identify the importance and frequency of measurement of each attribute.</b> Classify each of the attributes in terms of their perceived importance using a scale:</p> <p style="margin-left: 40px;">H High importance M Medium importance L Low importance</p> <p>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.</p>
Step 5	<b>Prepare a report card showing trends in the condition of the key attributes.</b> This involves an assessment of the current measurement of each attribute and rating it from Very Poor to Very Good.
Step 6	<b>Establish a management system for continuous improvement and refinement.</b>

## ▪ 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 page 31 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 4.6 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 below, 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  $-1.7\%$  pa 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
<u>Farm cash income</u> compared against average farm cash income of the industry group as reported in the Annual ABARE survey	High	Annually
<u>Farm business profit</u> compared against average farm business profit of the industry group as reported in the Annual ABARE survey	High	Annually
<u>Farm debt</u> at 1/7 compared against average farm debt at 1/7 of the industry group as reported in the Annual ABARE survey	Medium	Annually
Attribute	Importance	Frequency of Measurement
<u>Equity %</u> compared against average equity % of the industry group as reported in the Annual ABARE survey	Medium	Annually
<u>Rate of return</u> compared against average rate of return of the industry group as reported in the Annual ABARE survey	High	Annually
<u>Debt servicing ratio</u> 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**

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

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

**Indicator 3. Off site impacts**

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

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

**Indicator 4. Managerial Skills**

<b>Attribute</b>	<b>Importance</b>	<b>Frequency of measurement</b>
<b><u>Level of farmer education</u></b>	High	Annually
<b><u>Participation in training</u></b> to develop a sustainable and profitable system	High	Annually
<b><u>Implementation of sustainable practises</u></b>	High	Annually

**Indicator 5. Socio Economic Impacts**

<b>Attribute</b>	<b>Importance</b>	<b>Frequency of measurement</b>
<b><u>Age structure of the workforce</u></b>	High	Annually
<b><u>Access to key services</u></b>	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 eg. the chemical residue in produce. Hence it will be beneficial to attach the additional measurements to the report card.

**Table 4.8 Example Report Card on Fairview – The case study farm**

Indicator	Attribute	Measurement based on forecast @ 30/6/02	Trends				
			Very good	Good	Fair	Poor	Very poor
Long term Net Farm Income	Farm cash income	\$120,000		●			
Overall trend ↑	Farm business profit	\$95,000		●			
	Farm debt	\$450,000			●		
	Equity	84%			●		
	Rate of return	4.1%		●			
Natural resource condition	Nutrient balance P:K	P 13ppm K 200 ppm				←●	
Overall trend ↑	Soil acidity and sodicity	5.0 pH in CaCl <sub>2</sub>					←●
	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 experience but nil formal					●
Overall trend ↑	Participation in training	20 hrs pa				←●	
Socio-economic impacts	Age structure	53 yo					●
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 1: 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, which 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:

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	=	<u>\$18.00</u>
No of sheep to break even	=	1.07 sheep/ha

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

### Example 2: Raised beds

The use of raised beds on land which is gently sloping on which crops suffer as a result of heavy soils and waterlogging.

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.

<u>Capital cost</u>	<u>Cost/ha</u>
Contractor cost to set up raised beds, including surveying	\$200
Application of lime to correct excess acidity – 2t/ha @ \$40/t applied	<u>80</u>
TOTAL capital cost	\$280/ha =====
Annual cost	
Amortisation of bed costs assuming a 10 year write off and 8% interest \$280 x 0.149	\$41.72
Reshape beds \$30/ha every 3 years	<u>10.00</u>
TOTAL annual cost	\$51.72/ha =====

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 \$280/ha x 0.2505 = \$70.41 + \$10.00 = \$80.41. This is \$28.42/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.

## 5. THE ECONOMICS OF LEASING

Initially the financial performance of Australia's broadacre farm sector is considered, in order to identify trends which may affect leasing. The basic economic principles of leasing and leasing values are then discussed at the individual farm level.

### 5.1 Farm business performance

This section provides an overview of the financial performance of broadacre farms in Australia. The tables and graphs have been sourced from Australian Commodities Vol. 9 No. 1, March 2002 by ABARE and The Farm Monitor Project, 2000-2001, DNRE Victoria, and are provided in Appendix 2. You will note the following major issues arising from this data provided in Appendices 2.1 – 2.8.

- Appendix 2.1 and 2.2            The average farm cash income from all broadacre farms is forecast to be \$94,400 for 2001/02 up from \$71,390 in 2000/01 and \$51,352 in 1999/2000. Despite the greatly improved performance return on capital is still relatively low.
- Appendix 2.3 and 2.4            In 2000-2001 49% of all broadacre farms made a farm cash income of less than \$25,000 and only 35% made above \$50,000. There are approximately 111,000 farm establishments in Australia of which only 78,000 produce more than \$22,500 in gross income (source ABS). Approximately 65% of these broadacre farms produce 25% of production and 35% produce 75% of production.
- Appendix 2.5 and 2.6            Those farmers who are expanding are making higher incomes, have more debt and are on average aged 47 years compared with 58 years for those whose areas are contracting.
- Appendix 2.7 and 2.8            For a selected group of farmers in Southern Victoria – a more reliable part of Australia – income levels are very volatile and return on capital is low.

#### General observations

In Australia there are many small farms which do not provide an 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.

Most farms would benefit from non-farm income both as a source of additional income in good years, as a risk management tool, and as a means of retirement income.

The returns from farming are extremely volatile even in areas which have relatively little climatic risk such as southern Victoria.

## 5.2 Evaluating farm leases

### Economic principles

The economics of land leasing are relatively simple. The inputs into a farm system land, labour, machinery 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 and working capital.

### Economic inputs into a rural lease

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

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 rent should be expressed in terms of the effective area of the land.

### Returns and costs – the traditional model – see Table 5.1

#### *Landowner - returns*

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 5-6% of the broadacre land value. The capital gain depends on increases in land values generally. Rural land tends to rise after periods of increased commodity prices and falls when commodity prices are weak and interest rates high.

#### *Landowner - costs*

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.

**Table 5.1: A lease example**

1100 ha farm leased for @ \$110/effective ha which has an effective area of 1000 ha and is leased for \$110,000 per year.

<i>Landowner's Returns and Costs</i>			
Land Value		\$2000	\$800
(landowner's capital)		per hectare	per hectare
<b>Income –</b>			
Rent	(a)	<u>110</u>	<u>44</u>
<b>Costs</b>			
Rates and insurance		8	
Repairs to structures		2	
General overheads including accountant & telephone		2	
Interest on land loans		10	—
Total costs	(b)	<u>22</u>	<u>8.8</u>
Net income	(a – b)	88	35.2
		==	===
Gross return as % of land value	=	$\frac{\$110}{\$2000} \times 100$	= 5.5%
		1	===
Net income before interest as % of land value	=	$\frac{\$88 + 10}{\$2000} \times 100$	= 4.9%
		1	===

In addition to the rent return is 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% hence a long term capital gain of 3 – 4% is desirable. When this return is added to the net income above an overall return = 4 to 5% plus say 3% capital gain = 7 – 8%.

*Tenant – costs and returns - see Tables 5.2 and 5.3*

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. Using the same example as for the landowner the tenant's capital and returns are as follows:

**Table 5.2: A lease example**  
1000 ha farm leased for \$110/ha

<i>Tenant's capital – assuming the land is cropped</i>		
		<u>Notes</u>
Machinery capital	\$200/ha	
Working capital	<u>\$198/ha</u>	(\$250 direct costs + \$146 overhead costs =
Total capital	\$398/ha	\$396 ÷ 2 = \$198)
	===	
<b>Income and Costs</b>		
<b>Income</b>	<b>\$/ha</b>	
Average crop gross margin	300	Gross return \$550 (3t x \$180/t) on farm less direct costs \$250 = Gross margin \$300
<b>Less Costs</b>		
Rent	110	
Overhead costs	Interest	14 \$198 @ 7% average working capital
	Labour	15
	Insurance	2
Travel and sundry	<u>5</u>	
TOTAL costs	<u>146</u>	
before managerial allowance		
Managerial allowance	<u>15</u>	
Net Cash Income	<u>\$139</u>	

**Table 5.3: Cash income expressed as % of capital invested**

Return on capital	=	$\frac{\$139 \times 100}{398}$	=	34.92%	
				=====	
Very good year	=	$\frac{\$316 \times 100}{398}$	=	79.4%	(based on 4t yield @ \$180/t)
				=====	
Poor year – loss	=	$\frac{-\$126 \times 100}{398}$	=	(31.7%)	1.5t yield
				=====	\$450/ha = GM \$20 – 146
					= (\$126)

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.

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.

#### **Return and costs – an alternative model – see Tables 5.4 – 5.5**

In the traditional model just described the landowner makes a gross return of 5.5%, whilst the tenant makes a return of 34.9% in an average year, 79.4% in a very good year and a (31.7%) loss in a poor year.

The tenant is usually reluctant to pay rent in excess of 5.5% 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 sharefarming. These are called **participatory tenancies**.

The tenancies are described below by Bob Hall who visited the UK in 2000.

### **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 in the UK the subsidies. Subsidies take a lot of paperwork. For this he gets a fee of 5-12% 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. 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. 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?

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 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 ie. \$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 5.4: A barley crop – on leased land**

Crop gross margin		Poor	Average	Good
	Yield	2t	3t	4t
<b>Income</b>	@ \$160/t on farm	\$320	\$480	\$640
<b>Variable costs:</b> seed, fert., spray, contract				
harvest and management fee		<u>200</u>	<u>210</u>	<u>220</u>
Gross margin/ha		<u>\$120</u>	<u>\$270</u>	<u>\$420</u>
Contract fee		70	70	70
Rent 4% land value		<u>80</u>	<u>80</u>	<u>80</u>
TOTAL rent and contract		<u>(150)</u>	<u>(150)</u>	<u>(150)</u>
Margin available after rent & contract fee		(30)	120	270
		==	===	===
Rent received by Landlord	(80-30) 50	(80+60) 140	(80+135) 215	
Rent tenant receives	<u>70</u>	(70+60) <u>130</u>	(70+135) <u>205</u>	
TOTAL gross margin		<u>120</u>	<u>270</u>	<u>420</u>
Return on capital				
Landlord \$200/ha		2.5%	7%	10.75%
Tenant \$400/ha		17.5%	32.5%	51.2%

### Comments:

- The landowner replaces a certain 5.5% with a probable 7% but also takes a risk, associated with the risk is a potentially higher return or lower return.
- The tenant is guaranteed a 17.5% return on capital 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 (\$80/ha)
- If the gross margin is an agreed average one then the landowner receives an extra 2% - \$40/ha extra = \$120/ha in total (\$80 + \$40/ha)
- Any gross margin above the agreed average the landowner receives 15% thereof.

**Table 5.5: Using the earlier barley example**

	<b>Poor</b>	<b>Average</b>	<b>Good</b>
Crop gross margin	120	270	420
Landowner receives	80	120	142.50
		\$120 + \$22.50	
		\$420 – 270 = \$150 x 15% = \$22.50	
Tenant	40	150	277
Landowner Return to Capital (\$200/ha)	4%	6%	7.15%
Tenant Return to Capital	10%	37.5%	69.25%

#### Comment

Some risk sharing occurs:

- The landowner replaces a certain 5.5% for a 4 – 7%+ range
- The tenant receives a better return in a poor year and poorer return in a good year.

#### Final Comment

- 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.

## 5.3 Leasing values

An important issue for landowners and tenants is how much should be paid for the lease. Ultimately what is considered to be a fair rental will be determined by reference to market rates.

There are several rules of thumb which are used to analyse market rates and there are two main methods for representing rental rates.

Examples of leasing values:

<u>Method</u>	<u>“Rule of Thumb”</u>	<u>Conditions</u>
Rate of return	5 – 7% of land value p.a.	Landholder pays rates and property insurance.
\$/DSE	\$7.50 - \$10/DSE sheep \$10 - \$15 / dairy cow DSE	Tenant applies fertiliser

Recent examples of leases are now provided.

**Examples** – and how they have changed

<b>Land</b>	<b>Grazing 600mm rainfall not suited to blue gums</b>
2000	Land valued at \$600/acre for sheep/cattle grazing and capable of carrying 5 DSE/ac rented \$35/ac. This represents 5.83% gross to the landholder.
2001/2	The same land has increased in value to \$750/ac and would currently lease for \$40/ac or 5.3% of capital value
Land	Cropping 400mm rainfall – black soils
2000	Land valued at \$800/ac and suited to cropping leased for \$50/ac or 6.25% gross. Land valued at \$400/ac leased for \$25/ac 6.25% gross
2001/2	Similar to above

There is usually strong demand for the leasing of rural land and it is not necessary to advertise in the rural press to obtain realistic expressions of interest.

The landowner will view the rental income as a percentage of the land value as illustrated in the examples above. The tenant when determining how much to pay for a lease will consider the capital investment, the risk and the rate of return. See Table 5.6.

**Table 5.6: Tenant – lease valuation**

To determine how much to pay for a lease – using the earlier example and probability of outcome				
		Average year	Good year	Poor year
1. Expected gross margin		\$300	\$480	\$20
2. Expected overhead cost		(36)	(36)	(36)
3. Managerial allowance		(15)	(15)	(15)
Margin available for rent and profit	(a)	249	429	(31)
<sup>8</sup> Probability of outcome	(b) =	0.7	0.1	0.2
Possible value	(a x b) =	174	43	6
Most probable outcome	=	223	(174 + 43 + 6)	
50% to landowner	=	111.5		
50% to tenant	=	111.5		
		\$223		

The tenant believes that he is entitled to 50% of the return to allow for risk and the lack of capital gain.

The tenant must then compare what he is willing to pay with market rates.

The use of probabilities is only relevant if the lease is for a sufficiently long period of time so that an average range of seasons are experienced.

If a lease is short term eg 2 or 3 years then the chance of experiencing an overall most probable outcome is greatly diminished.<sup>9</sup>

To review the effect that the lease has on the farm's finances, turn to the Fairview case study (page 59).

<sup>8</sup> The probability reflects the farmer's expectation of outcome a 1-10 chance is expressed as 0.1.

<sup>9</sup> Different methods for valuing leases and sharefarming agreements are analysed in 'Sharefarming and Leasing Agreements - a practical guide', QDPI, Brisbane, 1999.

## **6. 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.

### **6.1 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 eg. 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 ie. 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 a 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 form of trust structure.

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 a 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*”.

## 6.2 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 3 for an example of a lease agreement.)

<b>Item</b>	<b>Information to be covered</b>
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.
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 workers compensation Not to fell timber or damage plantations.

<b>Item</b>	<b>Information to be covered</b>
	<p>To apply fertiliser at a prescribed rate (eg. \$2/DSE).</p> <p>Not to crop greater than XX hectares nor carry more than YY DSE.</p> <p>Maintain public liability insurance.</p> <p>To pay legal costs and stamp duty if payable (not in Victoria).</p> <p>Not transfer the lease without the landlord's consent.</p>
Dispute resolution	<p>- 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.</p>
Desirable conditions	<p>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.</p> <p>The cost of these reports could be shared by landowner and tenant.</p> <p>A report prepared using a digital camera and containing many photos is relatively easy to prepare and is excellent evidence.</p>

An example of a lease agreement is provided in Appendix 3.

## 7. BEST PRACTICE IN RURAL LEASING

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

### 7.1 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.:

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

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

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

- Market size
  - Market segmentation
  - Market growth potential
  - Seasonality
  - Competition
  - Market outlook
  - SWOT analysis of the market
6. Marketing Plan
- 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

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

- Product and service development
  - Strategic alliances
  - Resourcing
11. Financial Plan
- Investment analysis
  - Financing
  - Financial projections
  - Benchmarking
    - Business risk
12. Conclusion and Recommendations
13. Bibliography
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.

## 7.2 Assessing the lease property – pre lease

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.

**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 )

**Table 7.1 CONDITION REPORT – The lease property Fairview 400 ha**

REPORT PREPARED BY R.G. Ashby DATE August 2002  
 Rainfall 500 mm pa

Area ha	Paddock No	Water Supply				Fences	Pasture	Comments – all land is in pasture
		Troughs	Mills	Dams				
	1			3	2	1	Heavy infestation of annual grasses (AG)	
	2			3	2	1	AG 50% broad leaved 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. Broadleaved 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		

## **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 and when payments are to be made / date of possession
- Obligations as to
  - standard claims relating to repairs
  - financial obligations
  - special clauses eg. fertiliser
- Access – for the farmer and owner
- Special clauses re farming practices eg. 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:

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

Resow pastures	150 ha @ \$160/ha	\$24,000
Remove old fences and repair fences		5,000
Repair lanes and gateways		<u>5,000</u>
TOTAL capital needed		\$24,000
		=====
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.

### 7.3 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

1. Prepare a **business plan** to identify what role the property and its likely rental income will play in the long term plan.
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.
3. **Dates** – choose a suitable date for the lease commencement – Autumn or late Summer are usual times. They coincide with the start of season.

##### The Tenant

1. Prepare a **business plan** which identifies the role that a lease will play in the business and what represents a fair rent.
2. Seek out a suitable property. If none are advertised approach neighbours.
3. Inspect potential lease property.

### The Landowner

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 2 months and preferably 4 from advertising to occupation.
5. **Invite expressions of interest** in order to determine potential tenants.
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.
7. **Choose a tenant** – base the choice on the quality of their application, how they manage their own property and their financial strengths.
8. **Identify an independent consultant** to prepare a **condition report** on the property.  
  
Provide copies of the report to the tenant .
9. Provide a **tax invoice** at the start of the lease to the tenant.
10. Arrange a hand over date.
11. Identify an inspection review data and the reports that will accompany it eg. land use and fertiliser application proof.

Finally – Give the tenant “quiet enjoyment”.

### The Tenant

4. Prepare a plan and budget incorporating the lease into your current business. Identify how much extra working capital is needed.
5. Prepare a plan which can be submitted with an expression of interest. Include in the plan:
  - 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
  - list of referees – include bank manager/ accountant
6. Obtain a copy of the condition report and respond either to acknowledge that it is satisfactory or to resolve any potential problems.
7. Provide an annual statement of land use and or verification of the lease conditions eg. proof of fertiliser application.

Finally – we wish you excellent seasons and prices.

## 7.4 Ongoing management

Once a property has been satisfactorily leased it is important that the lease continues to be managed in an appropriate manner. We complete this book with an outline of issues which need addressing to demonstrate best practice lease management.

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.

Now review Bob Hall's views – A Consultant's View

### **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.

#### **Landlord (lessor) management**

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

1. Choose a tenant based on the manner the tenant's farm is run.
2. Make sure that the tenant makes a profit.
3. Will consider the property not just the profit.
4. Invest a % of the rental income back into the property.
5. Will take a long term perspective.
6. Will employ an adviser to represent him as an agent.
7. Visits the property occasionally.

A wise tenant (lessee) will act as follows:

1. Farm the land in the same manner as if it was owned.
2. Will not cheat.
3. 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 item 4 above.

## Part Two: A CASE STUDY ON FAIRVIEW

### THE JONES FAMILY FARM BUSINESS



# 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.

## 2. THE CASE STUDY DETAILS

### 2.1 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.

### 2.2 The Farm

The farm is 1200 ha of freehold land and comprises mostly gently undulating volcanic soils of which 1100 ha is arable.

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

The farm enterprises are a self replacing fine wool merino flock and a cropping operation. Contractors are used for spraying and harvesting.

### 2.3 The Business

The business is run as a partnership – W.A. and J.J. Jones. It has been quite profitable in the last two years, although very few significant profits were made in the 1990s.

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 fall again 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.

## 2.4 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.
- 

## 3. FARM FINANCES

### 3.1 Assets and Liabilities

**Table 1: Statement of Assets and Liabilities for W.A. & J.J. Jones**

	<b>@ 1/7/02</b>	<b>Forecast 1/7/03</b>
<b>Assets</b>	<b>\$000</b>	<b>\$000</b>
Land - 1200 ha x \$2000/ha	2,400	2,400
Stock - 6000 sheep @ \$40	240	240
Plant and machinery	100	100
Supplies	10	10
<b>TOTAL Assets</b>	<b>2,750</b>	<b>2,750</b>
 <b>Liabilities</b>		
Tax including GST	20	20
Bank loan 8% fixed	180	162
RFC loan – interest 7.5%	200	183
Hire purchase	-	-
Overdraft	50	50
<b>TOTAL Liabilities</b>	<b>450</b>	<b>415</b>
<b>Net Worth</b>	<b>\$2,300</b>	<b>\$2,335</b>
	=====	=====
Equity	84%	85%
	===	===

### 3.2 Farm Plan for 2002/2003 – no change

**Table 2: Stock Plan**

	<u>No</u>		<u>Rate</u>	<u>DSE</u>	<u>Total</u>
Open No	6000	Ewes	2500 x 1.5	=	3750
		Other	3500 x 1	=	<u>3500</u>
		TOTAL DSE			<u>7250</u>
Births	2000				
Purchases	<u>8</u>	Rams	8 x \$500	=	\$4,000
TOTAL	8008				
	=====				
Sales	1760	culls and cfa	760 x \$20		\$15,000
		wethers	1000 x \$30		<u>30,000</u>
Deaths	248				\$45,000
Close No	<u>6000</u>				=====
TOTAL	8008				
	=====				

**Table 3: Wool Income**

March shearing 19-20 $\mu$  wool, Spring lamb

$$\begin{aligned}
 5800 \times 4.5 \text{ kgs} &= 26,100 \\
 1000 \text{ ewe weaners} \times 2 \text{ kgs} &= \underline{2,000} \\
 &28,100 \text{ kgs} \\
 &=====
 \end{aligned}$$

Budget wool price – based on 950¢/kg for 19.5 $\mu$

$$\begin{aligned}
 &= \$5.75/\text{kg} = \$150,000 \\
 &=====
 \end{aligned}$$

**Table 4: Land Use and Stocking Rate**

Total area	=	1200 ha	
Waste and non farmed		<u>20</u>	
Effective area	=	1180 ha	
		=====	
Crop	460		
Pasture	<u>720</u>	1180 ha	
		=====	
<b>Stocking Rate</b>	=	<u>7250</u> DSE	= 10.07 DSE/ha
		720	=====

**Table 5: Crop Plan**

Crop	ha		Tonnes	on farm	Total
	area	t/ha		\$/t	\$000
Wheat	115	3	345	160	55
Canola	115	1.8	207	380	78
Peas	115	2	230	220	50
Barley	<u>115</u>	3	345	150	<u>52</u>
	460				\$235
	====				====

## Cash Budget 2002/2003

**Table 6: Cash Budget 2002/2003**

Income		<b><u>\$000</u></b>	
Wool		150	
Sheep	– sales	45	
	– purchases	(4)	
Crop		235	
Rebates and sundry		<u>10</u>	
TOTAL Income		<u>\$436</u>	
<b>Costs</b>			
Overhead – land and admin		60	
	– R & M	50	
Sheep		40	
Crop		115	
Pasture		12	
TOTAL operating costs		277	
Finance – loans interest		30	
	– overdraft interest	<u>8</u>	
TOTAL operating and finance		<u>315</u>	
Cash surplus from operation		<u>120</u>	(Farm Cash Income)
Less Drawings	50		
	Tax	20	
	Loans principal – RFC	17	
	principal – Bank	18	
	Machinery replacement	<u>15</u>	<u>120</u>
Cash surplus		Nil	
		===	

### 3.4 Discussion and Sustainability Report Card

Based on the outlook for 2002/03 and assuming an average rainfall year, the farm performance is forecast as follows:

- A cash surplus from operations of \$120,000 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	\$ 70,000
Repay loans	35,000
Replace machinery	<u>15,000</u>
	\$120,000
	=====

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 %.

- 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 ie Mr and Mrs Jones; and
- the decline in the provision of services in the region.

**Table 7: Sustainability Report Card**

Indicator	Attribute	Measurement based on forecast @ 30/6/02	Trends				
			Very good	Good	Fair	Poor	Very poor
Long term Net Farm Income	Farm cash income	\$120,000		●			
Overall trend 	Farm business profit	\$95,000		●			
	Farm debt	\$450,000			,		
	Equity	84%			,		
	Rate of return	4.1%		●			
	Natural resource condition	Nutrient balance P:K	P 13ppm K 200 ppm				←●
Overall trend 	Soil acidity and sodicity	5.0 pH in Cacl <sub>2</sub>					←●
	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 experience but nil formal					●
Overall trend 	Participation in training	20 hrs pa					←●
Socio-economic impacts	Age structure	53 yo					●
Overall trend 	Access to services	-					●

## 4. FARM EXPANSION

### 4.1 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 \$1m (ie. \$2500/ha or \$1000/ac). This is how much they need to buy a retirement house and invest to provide a pension.
- The market value of the property is probably around \$1800/ha (\$720/ac) or \$720,000 in total. Many of the fences on the property are falling down and the pastures are poor and have low fertility levels. They are also quite acidic.
- They would consider leasing the property if:
  1. they could remain living in the homestead; and
  2. they received an adequate rental income for their retirement needs.

The Jones would like to buy the property but are not willing to pay \$1m in order to do so. They will analyse the options and put a proposal to the Browns. They consider that \$800,000 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 values a lease of \$40,000 pa would be reasonable.

## 4.2 Farm Plan and Budget 2002/03 – 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 – say 360 ha effective

	ha	t/ha	Total T	\$/t	\$000
Canola	180	1.6	288	380	109
Wheat	<u>180</u>	2.5	450	160	<u>72</u>
TOTAL	360				\$181
	====				====

**Table 8: Assets and Liabilities – the affect of buying or leasing W.A. & J.J. Jones**

	@ 1/7/02	Buying	Leasing
<b>Assets</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Land - 1200 ha x \$2000/ha	2,400	2400	2400
400 ha x \$2000/ha		800	
Stamp duty and legal		35	
Stock - 6000 sheep @ \$40	240	240	240
Plant and machinery	100	200	200
Supplies	10	10	10
TOTAL Assets	2,750	3,685	2,850
<b>Liabilities</b>			
Tax including GST	20	20	20
Bank loan 8% fixed	180	615	180
RFC loan – interest 7.5%	200		
Vendor finance		400	
Hire purchase	-	100	100
Overdraft	50	50	50
TOTAL Liabilities	450	1,385	550
Net Worth	\$2,300	\$2,300	\$2,300
	====	====	====
Equity	84%	62%	81%
	====	====	====

**Table 9: Cash Budget 2002/03**

	Current	Buy land	Lease
Income	\$000	\$000	\$000
Wool	150	150	150
Sheep	45	45	45
	(4)	(4)	(4)
Crop – home	235	235	235
– new		181	181
Sundry	10	10	10
TOTAL	436	617	617
Payments			
Rent			40
Overheads:			
Land & administration*	60	70	65
R&M, fuel and oil	50	60	55
Hire purchase		20	20
Sheep	40	40	40
Crop – home	115	115	115
– new		95	95
Pasture	12	12	12
Finance – loans	30	30	30
– overdraft	8	11	12
– new loans 8%		67	
TOTAL operating	315	520	484
Cash operating surplus	121	97	133
Drawings / Manager	50	50	70
Loans – RFC and Bank	35	35	35
Tax	20	10	10
Machinery replace	15	2	15
TOTAL	120	97	130
	435	617	614
Cash surplus	1	Nil	3
	=	==	=
Add 2 DSE/grazed ha			
= 2 x 720 = 1440 x \$20			

\* Rates and insurance paid by landowner

## 4.3 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 HP contract then:

- debt would rise to \$1,385,000
- equity would fall to 62%
- a cash surplus from operations of \$97,000 would result (a reduction of \$23,000 from budget)
- no funds would be available to pay John – either that or loans would not be able to be repaid and or machinery replaced
- if a drought was experienced crop returns could be reduced by \$100,000 and significant cash losses would result
- 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 \$40,000 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 81%
- cash surplus from operations is increased to \$133,000
- 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 \$20,000 of drawings whilst still replacing machinery and repaying loans

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

## 5. LEASING ISSUES

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

Leasing offer

- Lease term            3 x 3 years    ie 9 in total
- Rent                    \$40,000/year or \$100/ha/year payable quarterly in advance.  
                              To be reviewed at the end of each 3 year term.
- 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:

Soil            - 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.

## 6. THE FUTURE

The family agree to lease the Brown's land and expand the partnership by the admission of John as a partner. John's fiancée will continue to work off farm (like all good viable farmers' wives should!).

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 \$40,000 p.a. or \$31,000 p.a. after tax, hence the \$20,000 drawing after tax represents a loss of \$11,000 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 initially aim to reduce debt. However once equity is above 85% (ie debts reduced by \$120,000) then the business will focus on building up non farm 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.

## REFERENCES

- ABARE, 2001. Australian Farm Surveys Report, ABARE.
- ABARE, March 2002. *Australian Commodities*, ABARE.
- Anderson, S., Lowe, K., Preece, K., Crouch, A., 2001. *Incorporating Biodiversity into Environmental Management Systems*, Department of Natural Resources and Environment, Melbourne.
- Ashby, R.G., 2000. *Systems Technology and Sustainable Resource Management – A Study Guide*, Marcus Oldham College.
- Australian Dairy Farmers Federation, 1997. *National Share Dairy Farming Guidebook*, ADFP, Melbourne.
- Broad, S., Fulton, A., & Clark, R., November 2001. *Land Tenure and Land Management Alternatives*, RIRDC, Canberra.
- CSIRO, *Sustainable Agriculture*, CSIRO Collingwood, Victoria, 1998.
- Golding, F., Smith, T., Bowen, J., 2002. *Rural Land Handbook – A guide for primary producers*, Victoria Law Foundation.
- Grasslands Society of Victoria, *Leasing Kit*, 2001.
- McFarlane, G. and Trewick, K., 2001. *Environment Best Management Practice on Farms*, Department of Natural Resources and Environment, Melbourne.
- Mills, C., Chapman L., Van Helst, R., 1998. Promoting Improved Land Management Practices on Farms. A Survey of landcare and land management related programs, ABARE.
- Pahl, L. and MacNamara K., June 2002. Environmental Marketing Schemes for Food and Fibre Production, Literature Review, QDPI.
- Rural Resources Group, 1998, 1999, 2000, 2001, 2002. *Annual Report National Landcare Facilitator Project*, RRG, Geelong.
- Tomes, Q.R., 1999. *Sharefarming and Leasing Arrangements – a practical guide*, Queensland Department of Primary Industry.
- Victorian Farmers Federation, Spring 2001. *Environmental Management Guide for Victoria*, VFF, Melbourne.
- Walker, J, Veitch, S., Dowling, T., Braaten, R., Guppy, L., and Herron, N. *Assessment of Catchment Condition*, CSIRO Land and Water, 2002.
- Walker, J. & Reuter, D.J., 1996. Indicators of Catchment Health – a technical perspective, CSIRO.

## **APPENDIX 1: 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.

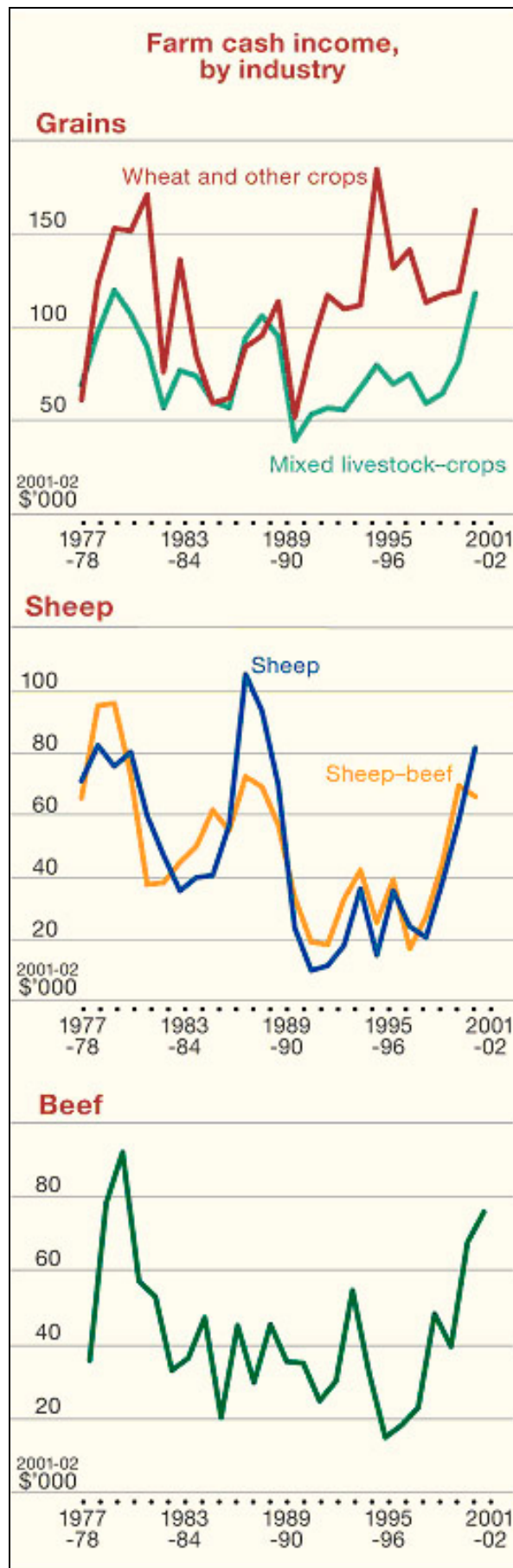
## APPENDIX 2: ABARE and Farm Monitor Project tables depicting farm business performance, Appendices 2.1 – 2.8.

### Appendix 2.1: Financial performance by industry average per farm, Broadacre farms

	Farm cash income			Farm business profit p			Rate of return a		
	1999 -2000	2000 -01 p	2001 -02 s	1999 -2000	2000 -01 p	2001 -02 s	1999 -2000	2000 -01 p	2001 -02 s
	\$	\$	\$	\$	\$	\$	%	%	%
Wheat and other crops	94 808	101 500	144 200	5 840	19 400	52 100	2.1	3.2	4.7
Mixed livestock–crops	51 006	68 300	104 000	-8 658	3 200	42 500	0.6	1.8	4.4
Beef industry	36 133	65 700	75 800	-7 292	10 570	39 800	0.2	1.4	3.2
- farms with less than 500 beef cattle	10 481	16 390	29 700	-33 817	-33 180	-12 400	-3.5	-3	-0.8
- farms with more than 500 beef cattle	101 827	214 220	235 900	60 641	142 320	187 100	3.1	5.1	6.4
Sheep industry	29 890	48 700	71 700	-20 522	-4 180	17 500	-0.3	0.8	3.2
- farms with less than 3000 sheep	10 545	25 280	39 600	-33 460	-24 470	-11 200	-3.3	-1.9	-0.2
- farms with more than 3000 sheep	54 880	78 830	105 800	-3 807	20 470	48 100	1.2	2.3	4.8
Sheep–beef industry	35 000	62 600	57 500	-12 689	16 520	17 500	-0.2	2.4	3.2
All broadacre industries	51 352	71 390	94 400	-7 536	9 400	39 800	0.7	1.9	3.7
Dairy	65 776	72 900	88 500	1 975	11 850	13 900	1.9	3.1	3.1

a Defined as profit at full equity, excluding capital appreciation, as a percentage of total opening capital. Profit at full equity is defined as farm business profit plus rent, interest and lease payments less depreciation on leased items. p Preliminary. s Provisional estimate.

## Appendix 2.2: Farm cash income by industry



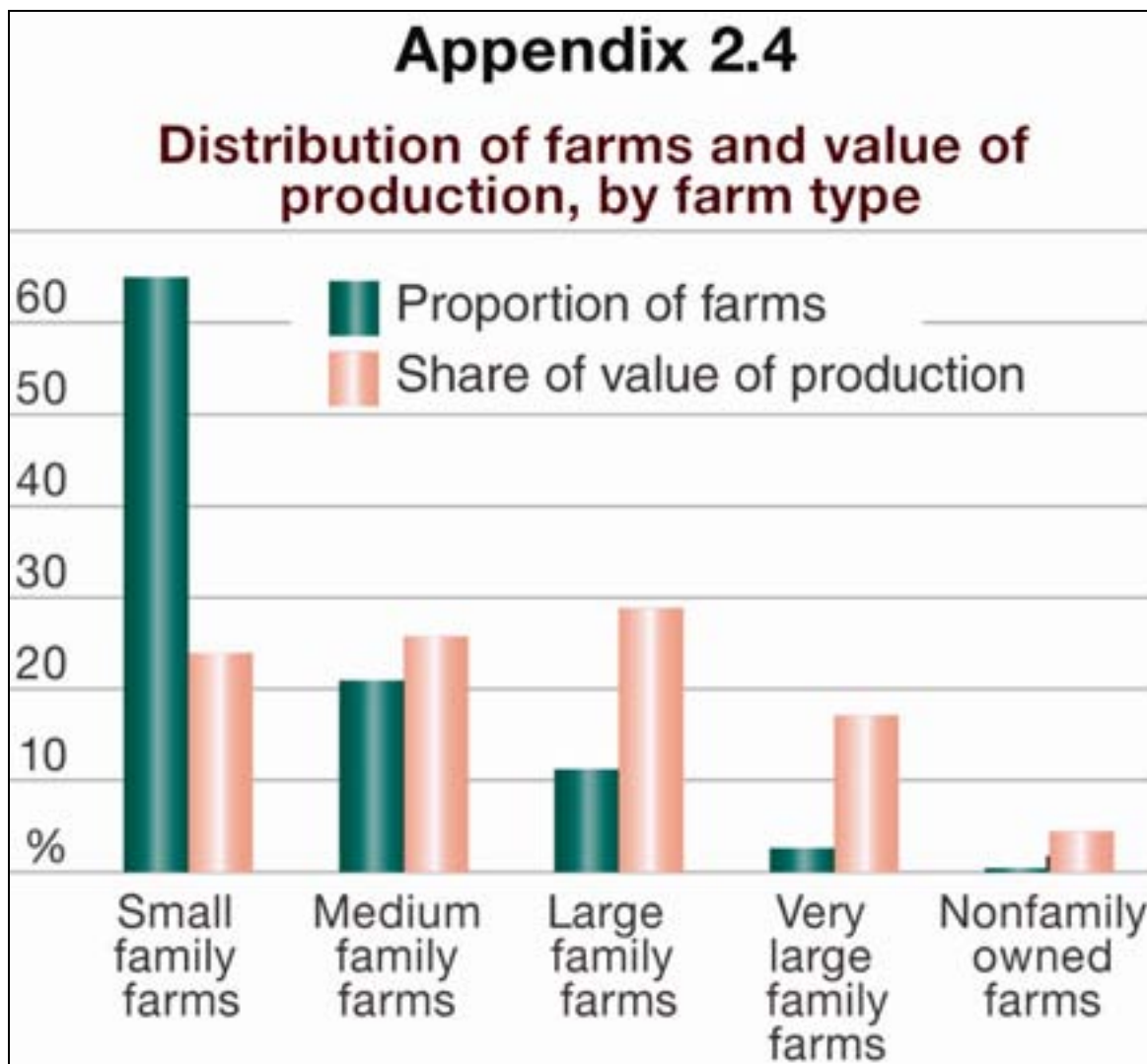
## Appendix 2.3: Farm Cash Income – Broadacre farms in Australia

(Source: ABARE Farm Survey 2001)

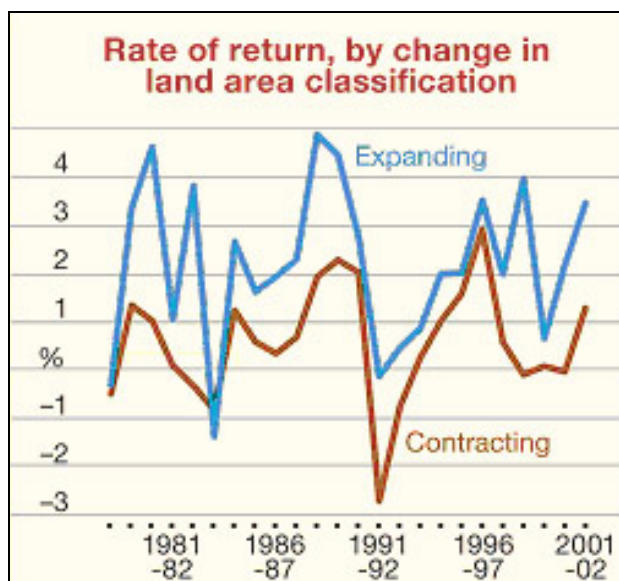
<b>Farm cash income</b>	<b>Unit</b>	<b>1998-99 <i>e</i></b>	<b>1999-00 <i>p</i></b>	<b>2000-01 <i>s</i></b>
Less than -\$25,000	%	6	7	10
-\$25,000 to 0	%	20	13	16
0 to \$25,000	%	29	29	23
\$25,000 to \$50,000	%	15	18	16
\$50,000 to \$100,000	%	17	14	16
Greater than \$100,000	%	14	19	19

*e* Final estimates; *p* Preliminary estimates; *s* Provisional estimates

**Appendix 2.4: Distribution of farms and value of production, by farm type**



## Appendix 2.5: Rates of return, by change in land area classification

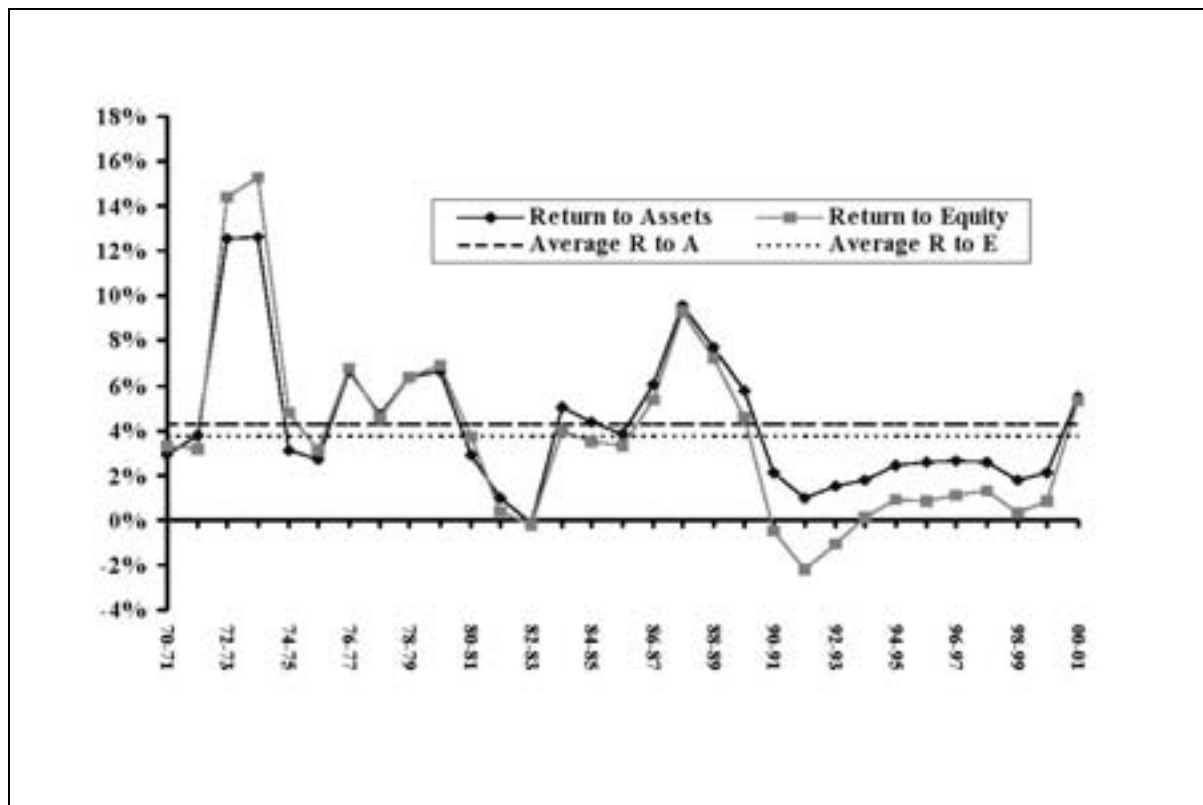


## Appendix 2.6: Physical and financial characteristics of farms with contracting, expanding and stable land area, 2000-01

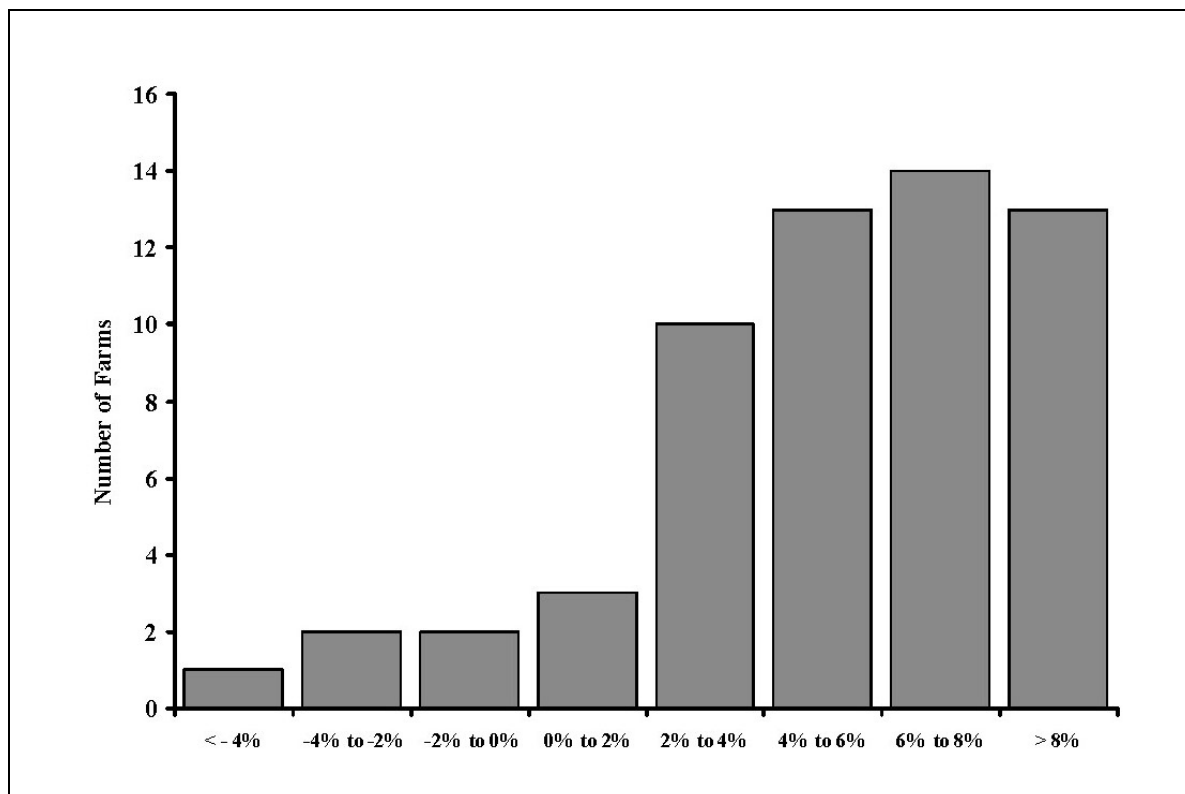
		Farms decreasing land area	Farms with un- changed land area	Farms increasing land area
Age of operator	yrs	58 (3)	55 (1)	47 (3)
Area operated at 30 June	ha	2 433 (63)	6 035 (11)	5 005 (27)
Average value of land at 30 June	\$/ha	465 (62)	244 (10)	400 (27)
Area sown to crops	ha	176 (19)	311 (4)	423 (18)
Livestock on hand at 30 June				
- sheep	no	1 612 (39)	1 464 (5)	2 202 (26)
- beef cattle	no	180 (31)	317 (6)	299 (29)
Wheat yield	t/ha	2.3 (12)	1.7 (4)	2.3 (11)
Wool cut per head	kg	4.3 (12)	4.6 (1)	4.2 (7)
Lambing rate a	%	90 (9)	79 (2)	85 (5)
Farm cash receipts	\$	216 536 (17)	242 076 (3)	368 883 (17)
Farm cash costs	\$	131 823 (26)	172 589 (4)	278 424 (18)
Farm cash income	\$	84 713 (16)	69 487 (6)	90 459 (22)
Farm business profit	\$	65(23 900)	8 429 (50)	33 858 (45)
Rate of return b	%	1.3 (107)	1.7 (15)	3.4 (24)
Equity ratio	%	90 (2)	89 (1)	82 (4)
Capital value at 30 June c	\$	1 131 778 (19)	1 470 577 (4)	2 000 208 (14)

a Number of lambs marked per ewe mated. b Rate of return excluding capital appreciation. c Capital value including leased items.

## Appendix 2.7: Average Farm Profitability: 1970-71 to 2000-01



## Appendix 2.8: Distribution of Farms by Return on Assets



## **APPENDIX 3: Sample Lease**

### **LEASE**

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 months 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 unremedied 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:-

*GST* 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 in 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 of 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) unpaid 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 overholding 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 of 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 overholding.
- (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]