

Leasing

Definition

Leasing occurs as a contractual agreement between a landowner (lessor) and a tenant (lessee) to lease the land and its fixtures. The transaction between the two parties is normally for a fixed period.

The lease agreement can cover:

- Maintenance and ownership of chattels
- Capital vs maintenance responsibility
- Fertiliser requirements
- Permissible activity on the land
- Any further party requirements e.g. re-grassing, development.

Benefits

Lessor

- Release capital from the farming business by selling livestock and plant
- Remove involvement in farm operations and management
- Provide a fixed and regular income without the risks associated with farming e.g. climate, market prices.

Lessee

- Pathway for increased investment in farming over time
- Able to get additional financial reward for high performance
- Grow management and governance capability
- Potential mentoring from landowner to accelerate development
- High return on equity
- Fixed term arrangement provides job and home security – recommend a minimum five year term.

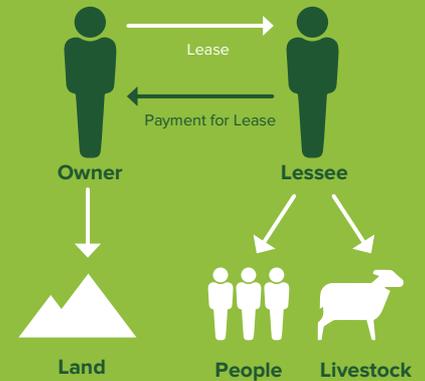
Mutual Benefit

- Limited interactions between parties can limit the likelihood of relationship breakdown
- Leases are understood by most parties due to them being widely used through various industries.

Elements needed for success

- Clear written agreement between the lessor and lessee. The agreement must be clear on issues around payment, term, exit, disputes, maintenance, responsibilities, communication etc.
- A lease price that both owner and lessee are happy with and allows both parties to be successful
- Have an independent party assess the condition of the farm, plant and infrastructure at the start of the lease period and annually thereafter to monitor that it is being maintained to the standard agreed within the lease terms and conditions.

Model diagram



Who could use this option

Owners who:

- Want to hold the farm for the next generation
- Want to retain the ownership of the farm but not the running of the farm
- Are not interested or able to continue day to day farming
- Want to take time off farm.

Lessees who:

- Do not have a large amount of capital to invest in land but want to have a farm business
- Want a steppingstone beyond farm management
- A lease could be used by another entity structure (e.g. an equity partnership) to grow the business without buying more land.

Further resources

www.knowledgehub.co.nz
Farm Ownership and Transition
Resource Booklet

Case study

Leo and Jane Littlewood have been farming their third-generation hill country farm for 30 years. At this stage their two adult children are not sure whether they want to take over the farm as they want to be close to their primary school and community. One of the children may consider taking over the family farm in five or so years.

However, Leo's health is not what it used to be, and the Littlewoods would like to spend more time with their grandkids in town or travelling overseas. They have decided that leasing out the farm is probably the best option in the short term given their circumstances.

Meanwhile, Sam Smith has been looking for a farm to lease. He is drawn to leasing as he doesn't have a huge amount of capital saved. He has learnt a lot over the years as a farm manager and wants to apply those skills to his own business and receive the financial rewards of doing so. He sees the Littlewood's 'farm for lease' in a local newspaper and arranges to meet with them.

They meet and discuss how the lease would work and what each parties' expectations are. The Littlewoods explain the lease is likely to be for around five years with a potential renewal depending on their family circumstances. Leo takes Sam for a drive around the farm to show him the current farm state.

They use the Federated Farmers website template Lease Agreement to ensure all the areas they should discuss and agree to have been covered off. After a few meetings they have agreed the terms and the price of the lease.

They want to make sure their initial thoughts on a lease price align to the market, so they make a phone call to the local trusted advisor who Leo has had a good relationship with over the years. They provide some high-level information which helps them to establish their lease price.

Each party then takes the agreement to their own lawyers to ensure the details meets their circumstance.

To avoid any conflicts the Littlewoods and Sam agree to appoint a third-party with experience managing leases to do an initial condition report and monitor the lease on an annual basis to ensure both parties are meeting their obligations.

Challenges

Some of the challenges in using the leasing model are

1. Farm maintenance and monitoring – clarifying who is responsible
2. Lease agreements that are not fit for purpose or contain details that the parties do not fully understand
3. There is no capital gain for the lessee so cash return is important
4. There is a risk to the lessee of having to buy stock at a high price then sell at a low price at the end of the lease period (therefore not making any money). This is managed by having an appropriate lease term
5. There can be conflicting needs with the lessee benefiting from short term production and cash returns and the lessor from the long-term management of the asset. This needs to be addressed in the lease agreement
6. It may be hard to agree on a lease price. The price should be set at a rate that will enable both parties to prosper.

Leasing

Steps to establish

Some initial steps are listed below:

Owner

- Consider your goals and aspirations over the next five to ten years. Does leasing out your farm match these needs physically, financially, emotionally?
- Get a market estimate for the value of the lease
- Decide on the term of the lease you would be comfortable with
- Review your property and the current state of paddocks (fertility, pasture quality), races, plant, buildings, facilities etc.
- Advertise or ask for offers of interest. Or approach an independent person who has experience with managing leases

Lessee

- Prepare a business plan which could look at:
 - » Long term aspirations
 - » Type of farm you would like to lease (size and land type)
 - » If you require staff to assist you in managing the lease block
 - » Whether you will be required full-time
 - » A financial budget and cashflow.
- Research what lease blocks are available
- Meet with your bank to discuss financing if required.
- Network and make it known that you are looking for a lease opportunity

Together

- You will need to work through various terms of an agreement together e.g.
 - » Term of lease
 - » Maintenance vs capital expenses
 - » Payment terms
 - » Monitoring and communication
 - » Right of renewal
 - » Use of an independent advisor to monitor the maintenance of the farm
 - » Engage with professionals in order to finalise the lease, e.g. lawyers and accountants
 - » Remember, a lease needs to be beneficial to both parties.