

# FACTSHEET

## Leasing

### Definition

Leasing occurs as a contractual agreement between a land owner and a tenant to lease the land and its fixtures. The transaction between the two parties is normally for a fixed period of time.

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 eg regressing, development.

### Benefits

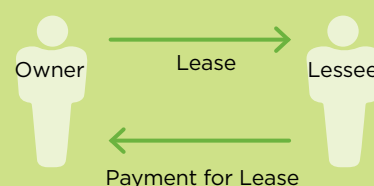
- Fixed term arrangement.
- Fixed price so provides certainty for both parties and also for financiers providing funding.
- Limited interactions between parties and these interactions can be outlined in the lease agreements – this can limit the impact of any relationship breakdown.
- Leases are fairly well understood by most parties due to them being quite widely used through various industries.
- Cash flow is spread over the life of the lease, rather than required upfront.
- In most cases the lease costs will be fully deductible for tax purposes. However for the owner the lease payments are likely to be taxable (as an income stream).

### Elements needed for success

- Clear written agreement between the owner and lessee. If the agreement is not clear on issues around payment, length, exit, maintenance, responsibilities, communication etc., this can cause friction.
- A lease price that both owner and lessee are happy with and allows both parties to be successful.
- Potentially the use of an independent 3rd party to review maintenance of the property (e.g. 6 monthly reviews of fencing, buildings and tracks).
- The right time period on the lease – if it is too short it won't be worth the lessee investing.
- 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 it is being maintained to the standard agreed within the lease terms and conditions.

### Model diagram

Terms of lease: Capital Maintenance, Term Length etc.



### Who could use this option

Owners who

- Want to hold the farm for the next generation.
- Currently have no obvious successor.
- 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.
- Would rather work on their own, than work for an employer.
- A lease could be used by another entity structure (e.g an equity partnership) to grow the business without buying more land.

## Case study

Leo and Jane Littlewood have been farming their 3rd generation hill country farm for 30 years. At this stage their 2 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 5 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.

They want to make sure that the price for the lease is appropriate for the market. They talk to their accountant and their financier to get an indication of what they can expect.

Meanwhile, Sam Smith has been looking for a farm to lease. He is drawn to leasing as he does not 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 5 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.

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

To avoid any conflicts the Littlewoods and Sam agree to appoint a 3rd party to monitor the farm on an annual basis to test for fertiliser, repairs and maintenance etc.

## 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. No capital gain for Lessee.
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).
5. The Lessee is unlikely to think about the long term welfare of the farm if it is a short term lease. They may try and maximise short term productivity at the expense of longer term productivity.
6. May be hard to agree on a lease price. The price must be set at a rate that will enable both parties to prosper.
7. Size of farm may not allow economies of scale and initial set up for lessee could be high. (e.g. equipment required).

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## Steps to establish

Some initial steps are listed below:

### Owner

- Look at your current profit, including your salary. Compare this return to what you would receive from leasing the property.
- 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.

### 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/cashflow.
- Research what lease blocks are available.
- Meet with your bank to discuss financing if required.

### 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.
  - If you will use 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 to be successful, a lease needs to be beneficial to both parties.

### Further resources:

[www.knowledgehub.co.nz](http://www.knowledgehub.co.nz) – Farm Ownership and Transition Workshop Resource Booklet