AN OPTION FOR ENTERPRISING FARMERS

CLA'S ASSESSMENT OF SHARE FARMING

CONTACTS

For more information on *An option for enterprising farmers: CLA's assessment of share farming* and the accompanying CLA handbook *A Practical Guide to Share Farming,* published in July 2014, contact:

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FOREWORD

The CLA has always been a proactive organisation taking the long-term perspective and, given the ever-changing dynamics within farming, we believe it is vital for the future of the industry that new and younger entrants see business opportunity. For this reason, the CLA has used its extensive experience to review the opportunities that share farming can provide as we face today's challenges.

Land is a scarce resource and one under increasing pressure from a growing population. We need smart and innovative land management techniques that provide social, environmental and economic benefits.

On the whole the farming population is an ageing one, with farmers wishing to retire from farming, or simply lessen their workload, finding it difficult to do so for a variety of reasons. This has a knock-on effect as it reduces opportunities for new entrants.

Share farming allows an ageing farmer to reduce his level of involvement, while also maintaining his interest and status as a farmer. In addition, it opens up an opportunity for younger new entrants with less capital to farm actively. The two parties collaborate and share their inputs, running individual businesses, for a production gain whilst accepting a full commercial risk.

Good land management, by whichever structure, depends on good working relations. Share farming requires a certain mindset and approach to ensure its success but can, if implemented correctly, provide a wealth of opportunities for the young right through to our older generations. The model share farming arrangement aims to bring energy, drive and ambition from one side with assets, knowledge and experience from the other to maximise the synergy.

The CLA's interest in share farming is long-standing and can be traced back to the ground-breaking work we carried out in the early 1980s. It is once again time to widen the range of options in the tool box to deal with farming arrangements. Share farming has its place in the list of possible farm structures that can help farmers to run their businesses as effectively as they would want.

I have no doubt this publication will be of significant interest to farmers and professionals alike, many of whom will find the accompanying CLA handbook *A Practical Guide to Share Farming* an indispensible tool.

Henry Robinson
President, CLA

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1. WHY SHARE FARMING?

The CLA has a long-standing reputation for protecting the interests of landowners, and those with an economic, social or environmental interest in rural land.

We believe that the adoption of share farming as a farm business structure is eminently suited to many of the challenges the industry currently faces. At its most simple, share farming is where two farmers agree to work together to share the farming of an area of land. They remain independent businesses with, usually, the owner providing land, buildings and fixed equipment, and the other farmer (generally referred to as the operator) providing the working machinery and the labour.

Both parties bring different and complementary resources to the business in terms of assets and abilities and so may be able to create something bigger and better than either could alone, but without being tied together in either a partnership or a tenancy.

Share farming will not be right for every situation, or for every farmer. However, there will be situations where it can provide real benefits both to the landowner and the operator, as well as help with the industry's problems with succession. The most suitable structure will be determined by identifying and agreeing the objectives of both parties.

The pattern of landholding in the countryside continues to change. Farmers as a whole are becoming ever more business-like and keen to find new, innovative ways of meeting their individual needs and aspirations. The traditional and proven landlord and tenant system may not be the only approach to farming and occupation of land.

The 2014 Oxford Farming Conference report *Opportunity Agriculture* found many informed industry commentators hold the "emphatic view that by 2024 there would be fewer owner-occupiers in agriculture and more contract and share farming". The report concluded that "by 2024 there will be a divergence between those owning land and those farming (operating) it. Therefore there will be considerable opportunities for farmers as operators".

The current age profile of farmers must change if society is to have the modern, entrepreneurial industry it needs. More people willing to take risks, acquire new skills and embrace new technologies will be required. But farming is not always an easy industry to enter – at the very least requiring a significant amount of capital upfront.

At the same time, we must not lose the benefits of the years of experience of the older generation. Established farmers have a huge knowledge of great value to their successors and this will be most effectively passed on if they remain actively engaged in the business.

In the right circumstances, share farming can provide many of these benefits and the CLA is once again raising the importance of this concept to policy-makers, to those thinking about how best to structure their farm business and to those considering how to enter the industry.

2. KEY POINTS

There are practical points that anyone considering entering into a share farming arrangement should keep in mind.

- Share farming must be approached with the right attitude; there is no question of one of the parties to a share farming arrangement trying to take advantage of the other. They are equals in a business contract which exists for their mutual benefit.
- Both parties must do their best if the arrangement is to succeed. The owner must provide the best equipment he can – he benefits if the farm is equipped for efficient production. If it has defects and constraints, these are reflected in a reduced share.
- The assessment of shares must be carefully prepared and then adhered to. Budgets should be drawn up for the whole year's operations and worked through to ensure that as far as possible no requirements are overlooked. Budgets must not be too optimistic; stock does die and crops do fail. Costs and performance are bound to vary from year to year.
- Each party must be happy that the agreement is fair. If one party is not happy he should not enter into the arrangement.
- There should be no guaranteed payments between the parties. Suppliers should be asked to send the two parties to the agreement individual invoices reflecting their respective shares of the amounts payable. All other shared items should be settled monthly by one party paying the supplier and then invoicing the other party for his share. There must be no netting of the costs.
- Where possible, purchasers should be asked to submit two cheques in respect of payments for sales from the farm. If this is not possible one party will receive the whole amount and then let the other party have his share. This can be resolved at a monthly meeting or sooner if needed.
- There must be no form of joint account or guaranteed charge. Each party must accept a full commercial risk.
- There should be provision for a review of the terms after the second year and annually thereafter.
- Professional advice must be taken on the agreement.

AN ACCOUNTANT'S VIEW

Within CLA membership there are many professional firms that work closely with CLA advisers and its landowning members. One such firm is Dodd & Co which specialises in accountancy and business advice. Rob Hitch, partner, advises farmers throughout the UK and often recommends share farming structures in cases where full joint venture arrangements have not been undertaken.

Rob explains: "Whilst properly drafted contract farming arrangements can provide certainty for landowners these tend to provide little of the tax benefits afforded to farmers to the contracting party.

"Share farming offers both parties their own farming business, providing capital taxes benefits for landowners and income tax benefits for operators from farmers' averaging and entitlement to herd basis treatment.

"By keeping two separate businesses each party is in control of their own costs but share the fruits of, and responsibility for, the gross output of the share farming venture. Agreements allow new entrants into farming whilst those providing land still take an active role in the management of the holding.

"Anyone considering contract farming situations, particularly in the livestock sector, should seriously think about share farming as it often offers a better solution."

3. STRUCTURE OF A SHARE FARMING AGREEMENT

As with any arrangement both parties must understand what they are providing and what they can expect in return, and the basis of the agreement should be set down in writing at the outset. However, there is no reason why it should not be amended, by mutual agreement, to reflect changing circumstances.

Share farming can take many forms, but what follows describes a typical arrangement.

The owner provides:

- the farmland;
- the farm buildings, and house(s) where applicable;
- fixed equipment;
- long-term care of the land;
- major maintenance of the house and buildings;
- insurance of the property;
- expertise;
- part of the working capital in the form of a share of actual inputs and a share in the ownership of the livestock.

The operator provides:

- labour;
- machinery (in longer term contracts he may supply some of the semi-fixed machinery, eg milking plant, mill and mix etc);
- expertise;
- part of the working capital in the form of a share of actual inputs and a share in the ownership of the livestock.

The inputs from each party are then valued on the basis of their 'annual rental value' so that the share profile can be determined.

The owner of the land receives his share of the actual commodity produced as his return for the costs that he has borne:

- no rent is received;
- he receives no guaranteed payment from the operator;
- there is no guaranteed income;
- he submits his own VAT returns;
- he works out his own profit and loss account for himself and HM Revenue and Customs (HMRC) according to the cost to himself of his inputs and the price he receives from selling his part of the commodity produced.

The operator receives his share of the actual commodity produced as his return for the costs he has borne:

- he is not paid for his labour nor for his machinery as such;
- he receives no guaranteed payment from the owner;
- there is no guaranteed income;
- he submits his own VAT returns;
- he works out his own profit and loss account for himself and HMRC according to the cost to himself of his inputs and the price he receives from selling his part of the commodity produced.

Share farming is most commonly confused with contract farming. In share farming both parties accept a full commercial risk, that is, there is no guarantee of profit for either party and neither party makes a guaranteed payment to the other regardless of the performance of the business.

Whilst at the outset there could be concern at the lack of guaranteed income, what the arrangement does provide is that in the good years the share profit reflects the performance of the business in lieu of a guaranteed rent or first charge.

Share farming allows both to thrive in the good years whilst proportionately sharing any losses in poorer times.

4. BENEFITS FOR THE OWNER

Share farming is one option in a number of arrangements relating to farming structures. There are some clear benefits to the owner from this type of arrangement which are summarised below.

4.1 Tenure

- The owner can allow the operator to use his farm without parting with possession. There is no grant of rights which allows the owner to maintain the most advantageous tax position.
- Other parties can be involved without the owner having to commit to the onerous liabilities of a partnership or corporate structure.

4.2 Liability and Risk

- The production risk is shared between the parties. A general partnership is a single business with both partners being jointly and severally liable for the liabilities of that business. In a share farming arrangement the two parties each operate separate businesses without any shared liability, there are two completely separate businesses, each with their own bank account and VAT registration.

4.3 Return

- Where the agreement results in a larger farmed area, buying and selling power can be increased, and fixed costs can be spread over a larger area.
- In good years the owner benefits from increased profit unlike with a tenancy where the return is fixed regardless of performance.

4.4 Taxation

- As a trading share farmer the owner puts himself in a good position to benefit from Agricultural Property Relief (APR). He will be considered to be farming the land so for the purpose of APR the landholding period requirement reduces from seven years to two. The main requirements of APR are being in occupation of your holding and actively involved in the trade of agriculture.
- Both parties in a share farming agreement can take advantage of tax benefits, unlike in a contract farming arrangement. When there is a difference in profits between two years, the profits can be averaged, giving a tax benefit, something which cannot be done under contract farming arrangements.
- Advantage can be taken of election for herd basis taxation. Often farmers have a lot of money tied up in livestock, and herd basis election can be very rewarding. This does require an overall election which is binding on both parties.

4.5 Management

- The owner retains a regular input in the management of his land. The owner does not have to be involved in the day-to-day running of the business, and other farmers can effectively buy into that business, putting in capital, without the owner giving up vacant possession.

4.6 Succession

- Farming landowners can use this structure to plan for family members to succeed to the business.
- Farming landowners who have no successor can continue to own and operate their farming business jointly with an operator.
- A useful phasing period is provided to those who wish to lessen the workload without giving up entirely.

5. BENEFITS FOR THE OPERATOR

Share farming is one option in a number of arrangements relating to farming structures. There are some clear benefits to the operator from this type of arrangement which are summarised below.

5.1 Entrance

- An additional opportunity for new entrants is provided even when there is a lack of suitable holdings on the open market.

5.2 Capital Input

- New entrants into the industry will need to find far less upfront capital than under a tenancy or purchase.
- The operator can develop his business revenues further as no capital is required for purchasing land.

5.3 Growth and Expansion

- Where two businesses combine through share farming the overall business can expand as the operator can bring in more efficient machinery and more stock, allowing capital to be saved.
- An operator can build up his share over the years by reinvesting his profit and undertaking a recalculation of the share. Therefore, for a new entrant, the initial capital costs can be relatively low.
- Where an owner is planning ahead for retirement, an operator can work with him to transfer the business over a phased period.

5.4 Efficiency

- Economies of scale increase buying and selling power which helps to reduce fixed costs.
- The business is able to spread its fixed costs over a much larger area.
- The operator is able to spread an element of his operational risk with the landowner.

5.5 Cash Flow

- Under a farm tenancy, rents are generally paid in advance but with share farming there is no charge for the use of the farm and buildings.

5.6 Experience and Knowledge

- A new entrant can learn from the knowledge, skills and experience of the owner whilst having a say in the management and running of the business.
- There is access to further agricultural knowledge through share farm meetings with a wider agricultural team.

5.7 Liability

- With a partnership there is a single business with both partners jointly and severally liable for the debts of that single business. In a share farming arrangement the two parties each operate separate businesses without any cross-liability.

6. HOW SHARE FARMING COMPARES TO OTHER ARRANGEMENTS

At the outset share farming was described as one of a number of options for farming structures. An owner, when deciding how best to manage and plan for his land, should consider the following:

1. sale of freehold;
2. long-term tenancy;
3. short- to medium-term tenancy;
4. licence;
5. partnership;
6. contract farming agreement;
7. share farming agreement;
8. farming in hand.

Each one of these options has advantages and disadvantages and they all have differing consequences and outcomes. The choice of structure will depend on the owner's objectives, what he is prepared to give and what he expects in return.

Anyone considering a share farming agreement should take professional advice and understand what will be required. It is imperative that the spirit of an agreement is understood and entered into freely and willingly. This type of agreement will simply fail if the parties are not able to work collaboratively for a mutual benefit.

There are, of course, other considerations such as long-term tax planning, level of management involvement required, risk and return on capital.

Share farming is designed to be flexible and adaptable to allow it to adjust to the farming climate at any one time. It is designed so that the parties work together for their mutual benefit and should not be considered adversarial.

When considering the list of options above, the security of tenure given away decreases from option one to eight, on the other hand, as the risk increases so too could the rewards.

A FARMER'S VIEW

In addition to pursuing a professional career, CLA member Daniel Fowler manages the family farm in Lancashire. The land is currently let to local farmers on grazing licences and there are times when Daniel's family would like more control over the land to ensure that it is kept in good heart.

Given the other issues he was keen to address – such as tax planning and succession for his 13 year old son – Daniel approached the CLA for advice. Having discussed his options with CLA professional advisers, he is now considering a move into share farming for a number of reasons.

He says: "I feel that share farming agreements are a great opportunity to give us as landowners the ability to keep an element of control over the use of the holding, create a good start for a possible new entrant and to maintain a viable business whilst still keeping an interest in the farming activities carried out on our land. A share farming agreement would be a great way of remaining involved in the rearing of livestock and operation of the holding without having the full-time commitment."

Daniel feels that a short-term let might not attract an individual with the drive, energy and enthusiasm required to help him meet the farm's objectives. He says: "Share farming is the best way I can think of to offer an ambitious young farmer with limited finances the opportunity they need to get on the farming ladder while at the same time creating a viable future for our farm."

Daniel also believes that share farming would enable him to help with the paperwork side of the business, which many farmers struggle to get to grips with.

He adds: "In my experience it is often the reams of paperwork that distract good farmers and take them away from what they do best. Share farming would allow me to shoulder some of that burden and still have time to take a more strategic view of the business while the operator gets on with the day-to-day running of the farm. Nobody is good at all aspects of farming and you need to combine skills and expertise for the greater good."

7. SHARE FARMING IN PRACTICE

7.1 A family estate in North Yorkshire

CLA member John Henderson first saw an opportunity to implement a share farming scheme back at his family's estate near Skipton on the edge of the Yorkshire Dales National Park during the early 1980s.

One of the estate's previously tenanted dairy farms needed new life breathing into it at the same time that young farmer David Coates, who had grown up on his parents' tenanted farm elsewhere on the estate, was looking for an opportunity to set up his own business.

Under John's guidance, David quickly set about transforming the farm into a thriving business and has never looked back. Today, David share farms with John extensively across the estate and also runs two successful businesses – a cross-country horse riding facility and a haylage company.

In 1992 John acted without hesitation when a chance arose to recruit a second young farmer to work with on the estate, and by the end of the year Tony Shepherd was up and running at St Helen's Farm, Eshton, with 150 sheep and a suckler herd.

The farming at St Helen's is based on an agreement between John and Tony, who is responsible for the daily running of the farm. John provides, maintains and insures the property while Tony provides labour and machinery. Each partner operates their own individual business, with no sharing of trading or bank accounts. Under this particular agreement, the split between the two is on a 67/33 percent basis.

"People can't believe it's as simple as that, but it really is," says John. "The problem with the landlord and tenant relationship is that regardless of how well you get on there always comes a point where you have to sit on opposite sides of the table and negotiate the rent. Share farming removes this from the equation completely and allows you to work more as equals in the same business."

This is a point that Tony totally agrees with: "Farming can be a lonely business," he says. "It's great to have a man of John's experience on hand to advise me on issues and also to be able to bounce around ideas about how we could be operating the business more efficiently."

By remaining part of the farming business, the landowner is able to benefit from various business reliefs such as reclaiming VAT on expenditure. Thanks to the CLA's work during the 1980s, share farming is recognised by HMRC and other rural economy stakeholders, such as Defra, so there are no complications in terms of Single Payment allocation – by default it is allocated to the partner with the higher share.

John is also keen to point out that a share farming agreement does not have to apply to a whole farm. He explains: "A landowner who farms 1,500 acres may have 200 acres on rotation, which he could offer to a young person on a share farming basis. Because there is no need to stipulate a specific plot of land, there are no geographical constraints as to where the farming takes place."

7.2 A farming enterprise in Northumberland

CLA member John Cresswell operates a farming business in north Northumberland. It is split evenly between livestock (sheep and suckler cows) and combineable crops. The cropping is again divided between an organic and a conventional enterprise.

Since the mid 1980s some 100 acres of the conventional cropping business has been farmed under a share farming agreement with a neighbouring landowner and friend, Lance Robson. The share farming agreement has allowed Lance to concentrate on his diverse and hectic core businesses, which include a substantial caravan site and holiday cottages.

"The agreement has worked well for us," says John. "It has allowed us to farm an extra area which has helped make our core business more viable, not least because the land is in exactly the right place. Lance has always been a farmer with other interests, and so the arrangement has allowed him to retain a sensible degree of control. And when things are good, he can expect to share the extra profit.

"I believe one of the reasons it has worked so well is that Lance has taken a very long-term view – we have no problem in justifying to ourselves an equally long-term approach to the care of the land. To allow issues such as organic matter or nutrients or pH levels to go wrong would hit me as much as him, if not more. This is clearly in the interest of both parties, and in the interest of the land itself."

7.3 A mixed grassland farm in Somerset

Somerset farmer James Small is a CLA member who farms a 1,000 acre mixed grassland farm in the heart of the Mendip Hills in partnership with his family. For the past four years the business has share farmed a flock of 1,400 Beulah ewes with Sue Hartley.

While the family partnership retains ownership of the land and stock, Sue is the registered keeper of the flock and is responsible for its health care as well as all labour. Under this particular agreement, the split between the family partnership and Sue is on a 50/50 basis.

James explains: "Sue gets on with the day-to-day running of the flock and we have regular management meetings to make sure that we're both happy with the way the business is performing and the direction we're moving in.

"The key to a successful share farming agreement is a fair and equitable decision-making process between both parties. We have an equal say in the business and so there are no major decisions taken unless we are all in agreement.

"If a landowner is willing to approach share farming on a truly equitable basis and can have an honest and open working relationship with the farmer they're working with, then it is a great option."

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