New Entrants to Farming Fact Sheet

Joint Ventures

What are the Opportunities for Arable Enterprises?

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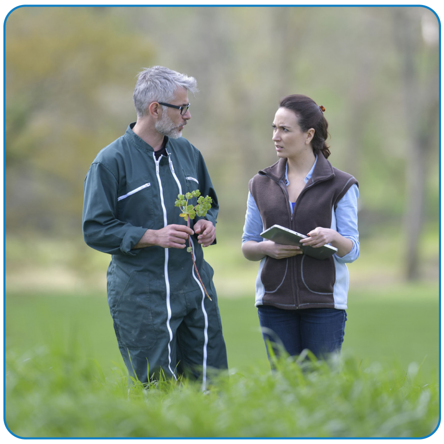
There is perhaps a presumption that joint venture arrangements are constrictive in nature in the same way perhaps that Farm Business Tenancies are viewed as being the more formal agreement arrangements.



Ultimately, the attraction of a joint venture should be the flexibility to design the arrangement to best suit the needs of the parties involved; they should be bespoke agreements which reflect the circumstances of the contracting parties and clearly set out their respective rights and responsibilities. For all concerned it should be a win: win scenario and yet still flexible enough to allow adaptations to change in circumstance arising from either internal or external influence.

Why might farmers opt for joint ventures?

Rationalising fixed costs

- **A major consideration in most of the joint ventures. Careful pooling of machinery and labour can lead to significant savings in fixed costs per hectare and a more rigorous focus on budgets.**

Sourcing investment

- **A joint venture partner may bring investment with him/her (reflected in agreed profit shares).**

Getting the right people in place

- **A larger operational area may provide an opportunity for the next generation to step up and allow the older generation to step back. Collaborations can mean a wider range of skills are available.**

Finding a secure supply of land to fulfil contracts

- **A joint venture may be an alternative to a traditional farm business tenancy, particularly where there are synergies with other parts of a farming business.**

The European Agricultural Fund for Rural Development
Europe investing in rural areas

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Stepping back while maintaining trading status

- **For those wanting to retire but needing to maintain their trading status for tax purposes, a joint venture may be a way forward, bringing in others to look after day-to-day operations while continuing to have management control.**

Who might consider a joint venture?

- **A new owner or entrant with no immediate wish to finance or manage the farming business.**
- **A tenant, who, whilst continuing to farm, seeks a secure income from the arable side of their operation and is fully permitted to do so within the terms of their Tenancy Agreement.**
- **A landowner who is presented with a block of vacant land on the departure or termination of a tenancy.**
- **An existing farmer who for reasons of either economies of scale, or cost of capital replacement, or absence of successor, wishes to release working capital and reduce risk, whilst still maintaining some of the financial benefits of being a 'working' farm.**

To surmise however, that joint ventures have a pre-disposition to a 'sleeping partner' arrangement would be wrong and whilst contract farming, as a form of co-operation, may be more closely aligned to such an arrangement, share farming and partnerships, can facilitate the combined ambitions of two or more fully engaged parties.

Each joint venture will be unique, and the operational basis can vary, but the common factor to all is that the members are all working towards a similar goal.

What format do joint ventures take?

- **Contract farming arrangements**
- **Share farming arrangements**
- **Sharing of individual machines**
- **Machinery syndicates**
- **Machinery syndicate/share farming combinations**
- **Limited liability partnerships**

Regardless of the type of joint venture agreement, there are several key provisions that should be considered by the parties.

Responsibilities

Agreeing and detailing the responsibilities of both parties to the joint venture must be included in any agreement. Parties should have a clear understanding of what is expected of them so that work is neither duplicated nor disputed.

Profit and Loss

The extent to which profits and losses are apportioned should be clearly agreed at the outset of any joint venture to reflect the contributions and commercial aims of the parties. Consideration should also be given to potential periodic reviews of profit and loss apportionment to reflect the subsequent understanding between the parties.

Termination

Mechanisms need to be incorporated in any agreement which specify why, when, and how either party is able to terminate the agreement.

Similarly, the inclusion of a dispute resolution procedure should be agreed to allow for swift resolution in the event of a dispute arising. A smooth exit from the agreement will enable both parties to assess their next steps and proceed as cost effectively as possible.

Contract Farming Agreements

The Farmer provides the land and any existing, fixed equipment, for example, grain storage/driers (if required or agreed) and also provides a dedicated bank account which funds the contractor's charge, all variable costs, and an agreed element of fixed costs. The account also receives all crop sales and subsidies. For this duty, the Farmer receives what is commonly termed a basic retention/fee in the form of a fixed sum per ha. The Farmer retains trading status for income and capital taxes – and must remain involved in management decisions on cropping and land use, so regular meetings should be held, and decisions documented.

The Contractor provides the machinery and staff to run the farm including to an agreed extent the hands-on management. This will generally incorporate the purchase of inputs e.g., seeds, fertiliser, pesticides, and sales of crops. All of this takes place within a budget and cashflow originated with and necessarily approved by the Farmer.

The Farmer receives the "Farmer's retainer" and the Contractor receives the "Contractor's charge" (usually quarterly or half-yearly) The resulting divisible surplus is split between the Farmer and the Contractor, typically 50:50 for the first tranche of surplus and if the surplus goes above an agreed level, there is a second tranche split which is more in the Farmers favour, for example, 80:20. (N.B. The ratio of the Farmers Retainer and Divisible Surplus i.e. the risk ratio can be adjusted for each individual requirement.)

Example Contract Farming Agreement budget – 200ha

	Farmer		Contractor		Totals
	£/ha	£/total	£/ha	£/total	£/total
Gross Margin	576	115,200	-	-	115,200
BPS	233	46,600	-	-	46,600
Total		161,800	-	-	161,600
Less property maintenance		600	-	-	600
Drying and insurance		600	-	-	600
Retentions/ha	240	48,000	240	48,000	96,000
Balance 50:50		32,200		32,200	64,400
Net Received		80,200		80,200	160,400
Net/ha		**401**		**401**	

This is an income which is comparable to the rent the Farmer would receive for a 3-5 year Farm Business Tenancy, but by partaking in the agreement they retain control of farming practices and the tax advantages of being a trading business.

Share Farming

What are the principles of share farming?

Within this agreement two or more farmers agree to share both the costs and sales from farming the same unit. Each operates a separate farming business running their own bank accounts and accounting separately for their own tax and VAT returns. There is no partnership and no employment contract; in its place is a commercial contract, which sets out the responsibilities for inputs and how the proceeds are divided.

One of the biggest benefits of share farming is that it's a very flexible model, which allows different levels of involvement and investment, depending on what each party wants. Potentially, two or more farmers may amalgamate their arable enterprises and then choose to utilise contractor services, or a joint venture machinery syndicate to provide the labour and machinery and then the cropping is share farmed. The permutations are numerous.

Agreement structures

An agreement should:

- **Set out the details of the farm,**
- **Detail the overall basis of the agreement,**
- **List what inputs each party is responsible for,**
- **Delineate proceeds are to be divided,**
- **Cover options for review if business conditions change,**
- **Describe the overall farming policy and details of what operational activities each party are responsible for.**
- **Cover direct payments and environmental schemes and where responsibilities between the parties lie.**

The agreement also needs to be clear about how long it lasts and how parties can end it and its advisable to 'stress-test' the agreement on different outcomes; what happens for example if market outlets are lost? or, what happens in the case of prolonged illness?

How are the monetary transactions dealt with?

For crop sales, an administrative bank account receives income, and the money is transferred back to members in the agreed ratios. For items such as pesticides and fertilisers, to avoid asking suppliers to raise invoices to each party, better for one member to purchase and invoice back to the others. Seeds are more complex because there are potentially royalty implications for a farmer selling seed, so one member of the agreement needs to purchase seeds as an agent, with other members reimbursing them for the agreed percentage of the purchase.

If one party is bringing the land and buildings to the venture, they would typically be responsible for insuring them and maintaining them. The other party might be responsible for insuring and maintaining the machinery they bring and for operational activities.

Tax and legal advice should always be taken before deciding what farming model is most suitable in any circumstance and because costs and sales are shared, correctly structured share farming arrangements are endorsed by HMRC as a trading farming business and as such benefit from Inheritance and Capital Gains tax relief. Care must be taken however with those businesses wishing to maintain 'trading' income levels over and above 'investment' income where eligibility for Business Property Relief is important.

Example of a share farming agreement structure

In this case, the farmers are neighbours and know each other well. Both wish to remain actively involved in trading and are both willing to take on the associated risks that brings. They need to factor in that one of them has better quality land and also account for the relative value to the joint venture from each in providing fixed capital items as well as labour, machinery, and management input time.

Farmer A	
Brings to the agreement 300ha with a productive 'rental value' calculated to be equivalent to £160/ha	£48,000
Fixed assets – grain store utilised at cost of £20/ha across combined area of 500ha	£10,000
Farmer A total contribution	**£58,000**
Farmer B	
Brings with him better quality soil – 200ha at £180/ha	£36,000
Machinery and labour at cost of £295/ha across 500ha	£147,500
Day to day management charged at £25/ha across 500ha	£12,500
Farmer B total contribution	**£196,000**

The combined contribution to the share farming venture totals £254,000; Farmer A has a 23% stake by virtue of the £58,000 investment and Farmer B has a 77% stake by virtue of the £196,000 invested.

Trading surplus distribution from 500ha achieving an average gross margin of £576/ha	£288,000
Farmer A's allocation	£66,240
Farmer B's allocation	£221,760

Equity Partnerships

For those wishing to release capital from land for alternative investments or facilitate partial retirement as part of a structured succession, particularly with non-family members, then Equity Partnerships may benefit. Equally, an equity partnership venture can also provide the vehicle by which those who are unable to finance a farm tenancy or ownership as an individual can still invest in farming. It can also be an opportunity for outside investors and for existing farmers to grow their business.

With the potential for multiple investors, an equity partnership is often formed as a company; shareholders pooling capital, identifying assets for investment, with the aim of generating greater growth. There are various structures but in essence the equity partnership provides a transparent share agreement – any financial surplus is shared by each partner and reflects their capital shares held in the company.

The need for clear understanding

The biggest factor to success through this mechanism is good relationships. Two or more investors increase the risk of disagreement over strategic direction or losing confidence during any period of successively low profits.

Decision-making can become bureaucratic and slow. Changes in business or personal objectives of one partner can affect the other(s). Each partner needs to have a clear understanding of their role and responsibilities within the partnership and be honest about their motives. A robust process (due diligence) is required to ensure the people you are looking to invest with have similar values, purpose, and vision. Regular board meetings are required to aid communication and help drive the business.

Concluding remarks

Perhaps it is all too easy to continue to do what you've always done, until maybe you find that instead of spending time maximising profits you are in fact only working to minimise losses. Perhaps a future reduction in area subsidy payment will be the instigator that leads you to review your business structure.

In arable scenarios particularly and especially with regard to syndicates or sharing arrangements, it is clearly evident that labour and machinery costs are often in excess of £150/ha lower than that of the average ''individual' farming businesses.

Why might that be? – greater economies of scale achieved, members working towards a common goal, better scrutiny, and accountability all feature. And not only should the financial situation improve, but new skill sets can also be introduced, succession can be planned, and time freed up both for family and new projects.