I AM CONSIDERING LEASING LAND.... HELP!

AN INTRODUCTION TO LEASING

Leasing property can provide a way to expand your farming operation and increase economies of scale without investing in land, which can be cost prohibitive (particularly for young farmers). A lease is where the you pay an agreed fee for the use of the lessors land for a prescribed period (normally 3-5 years).

This factsheet introduces the concept of leasing and outlines the advantages and disadvantages to both the lessor and the lessee.

Before we start..... let's explain some key terms.

Lessee

The tenant. You!

Lessor

The land owner.

Leasing

Leasing describes a right for a specified lessee to rent a piece of land from the lessor.

Lease Agreement

A lease agreement is normally drawn up prior to the commencement and provides detail about the lease, such as; name of tenants, description of the lease property, term of tenancy, lease payment amount, who is responsible for repairs and maintenance to fixtures, and the lessors right to enter the property.

Economies of scale

The gaining of a proportionate lower cost of production (cost/hectare) as fixed costs are spread across an increased level of production (more hectares).

Opportunity cost

The amount of income that would be earned if that resource was put to an alternative use (e.g. if you own a piece of land and decide to lease it, the opportunity cost - income foregone - is if you farmed the land instead yourself).

Due diligence

Research, investigation or examination (homework!) performed before entering into a transaction. In regards to leasing, it is important to carefully assess the opportunity (the land, the land owner etc.) and your own resources (labour, cashflow etc.) before moving forward.

Why might you consider leasing?

- Expand your business without the huge upfront capital cost of buying land.
- You may be looking to grow your operational business but not increase your land base.
- It may free up additional capital to spread over other investments (i.e. off-farm investments).
- You may have excess machinery, labour and equipment and by leasing additional land you use this more efficiently. Better match your resources to the land under your operation!
- Enables a reduction in your cost of production as fixed costs are spread over a larger productive land area. This leads to greater efficiency in your business and economies of scale, as although variable costs may increase, the overall cost of production should decrease as fixed costs decline as a proportion of income.

Table 1 Advantages and Disadvantages of Leasing Land (Original source: Hudson Facilitation, GRDC, 2014).

	ADVANTAGES/OPPORTUNITIES	DISADVANTAGES/RISKS
Lessee (tenant)	• viable means for business expansion without debt/land purchase • economies of scale in operations • reduced cost of production • climate variability • justifies purchase of more efficient equipment • increased profitability	• no exposure to capital gain • payment of lease cost regardless of season (production and market risk) • uncertainty of continuing access to land • machinery may not be adequate to cover increased area • may not gain long term benefits of investment in land productivity (e.g. weed control, soil improvement)
Lessor (landowner)	• no climate/production risk • reliable income/cash flow • opportunity for capital gain • no working capital required • little/no labour input required • no market risk • may continue living on the farm	• maintenance risk (soil health, weeds, infrastructure) • little/no say in decision making • reliant on financial viability of lessee • dispute with lessee • may be more difficult to sell land

Questions to ask yourself
before considering leasing

- [ ] Can you fulfill your part of the lease, both operationally and financially?
- [ ] Do you have the resources to undertake the lease (e.g. labour, management capacity, machinery, funding)?
- [ ] What are the inputs you require (e.g. fertiliser)?
- [ ] Do you need to travel to the property? You need to value your time!
- [ ] Have you prepared a budget? This is critical to determine the best/average/worst scenario (we help you with this!)
- [ ] Will your overall business profitability increase by introducing this land under your management?
- [ ] Have you done you due diligence? Can the property produce what you need to meet your production needs? Do you know the Lessor and is this a person you can have a business relationship with? Talk to people "in the know", get educated!
- [ ] What is the term of the agreement? It may be worthwhile paying above market to get a longer-term lease on land that suits your needs. Learn about agreements here.
- [ ] Can you negotiate an option to purchase or at least a right of refusal? It may be worth paying a premium for this option.
- [ ] Find out what is important to the lessor. Are they just looking for the best possible return or are they looking for someone who will look after their land how they would?
- [ ] Ensure the lease agreement is reviewed by your advisors (e.g. Accountant & Solicitor). We help you with this here.

Taxation implications

The decision to lease land can have a range of taxation impacts for you.

Income generated from the property are included as taxable income, including:

- Sheep sales
- Cattle sales
- Grain sales.

Expenses incurred are tax deductible, including:

- Lease fees
- Legal fees to review the agreement
- Input costs (e.g. fertiliser & chemical costs)
- Repairs and maintenance (e.g. fencing).

Timing of when the expenses are incurred is important:

- Your taxation position can be affected depending on if the expenses are incurred before or after the end of the financial year (June 30th).

Costs that are incurred where the benefit will be enjoyed beyond the lease agreement should be carefully discussed and negotiated with the land owner.

Legal implications

Solicitors assist lessors and lessees separately to negotiate and draft the terms of the lease.

Legal advisers are generally engaged once the parties have met, inspected the property and come to an agreement on some of the essential terms such as the lease rate and payment of outgoings (e.g. council rates and the area of land to be used).

In many cases a simple lease with the bare essential terms may be sufficient until something goes wrong, or a dispute arises. Then it can become awkward to work out a resolution while each party deals with the issue from their own perspective and tries to cover their own best interest.

It is common for people to rush and draft an insufficient lease, which later has its deficiencies exposed. In many cases problems arise because one party breaches an essential term of the lease for example, by not paying the rent or not using the land as agreed, which can present difficulty if the lease does not sufficiently prescribe how the parties are to deal with such an issue in the lease properly.

Unfortunately, this can lead to one party acting to protect their own interests and in doing so exploiting the interests of the other, which may not always be intentional but can come about due to the awkwardness of dealing with a difficult issue.

Leasing resources

IN THE YOUNG FARMER **LEASING & AGISTMENT TOOLKIT** WE HAVE A NUMBER OF RESOURCES TO HELP YOU IN NAVIGATE LEASING LAND:

1. Videos with experts
2. Sample lease agreement
3. Lease budget calculator
4. Lease checklist

....and much more!

- Successful land leasing in Australia (AgriFutures Australia)
- Leasing Dairy Assets Resource Pack (Dairy Australia)
- Leasing and share farming fact sheet (GRDC)
- Farm Leasing (Farm Table)

LEASING & AGISTMENT TOOLKIT

This factsheet was prepared by Airlie Landale (Farm Table) for the Young Farmer Business Program with the assistance of Agripath, Walsh & Blair Lawyers and RSM Australia.