HOW MUCH SHOULD I PAY FOR LEASED LAND?

DEVELOPING A LEASE BUDGET

There are several ways to calculate a lease value for agricultural land and this factsheet will introduce you to them!

The accompanying **lease calculator** and **explainer videos** will help you calculate a lease budget. These will enable you to enter discussions with the landholder with some options and with a deep understanding of what is viable for you.

Before you start..... ask yourself a few questions!

Consider answering the following questions before you get started:

1. What will I be producing on this leased country?
2. What do I expect my gross margins to look like, for each type of asset I will be operating (e.g. cropping, horticulture, livestock)?
3. What kind of running costs (overhead costs) do I expect?
4. What capital requirements will I need to undertake these operations? How am I going to fund this?
5. What is my current financial position and what will my new position be with the lease included?
6. How much of my operating profit will be retained after paying my lease?
7. How will my capital position have changed having had the lease? Have I built my assets (e.g. in livestock or machinery)?
8. Do I have other financing commitments (e.g. interest) that I also need to cover out of my operating profit?

Creating a lease budget

Developing a lease budget is critical for your own business knowledge and to guide lease negotiations with the land owner. Without one, you will be unprepared to discuss lease prices and may end up committed to pay for an amount far beyond the productive capacity of the land or beyond your capacity to pay.

A lease budget will enable you to enter conversations with clear thoughts about how much you are able to pay, and why. It will also determine how much working capital you will need to run your desired enterprise mix on the lease property.

Sensitivity analysis and multi-year budgeting is also very important to ensure you are covered for the possibility of poor seasons over a number of years. Be realistic with your figures. Research, ask questions, and don't be afraid to ask for help!

Expense items to consider in your lease budget include:

Expenses

- Lease cost
- Labour
- Machinery
- Stock
- Crop and/or livestock direct costs
- Repairs and maintenance
- Travel
- Legal costs
- Accounting costs
- Borrowing costs
- Electricity
- Insurances
- Fuel and Oil

NSW GOVERNMENT Department of Primary Industries
Young Farmer Business Program

What is a fair lease rate?

There are a range of methods you can use to establish a lease rate.

We recommend using at lease three methods of lease calculation (percentage of land value, percentage of gross margin and percentage of operating profit) to provide you with as much information to enter negotiations with.

Our Lease Calculator will help you to do this!

The rate agreed upon must reflect the nature of the asset and its productive capacity and the risks taken on board by each of the parties.

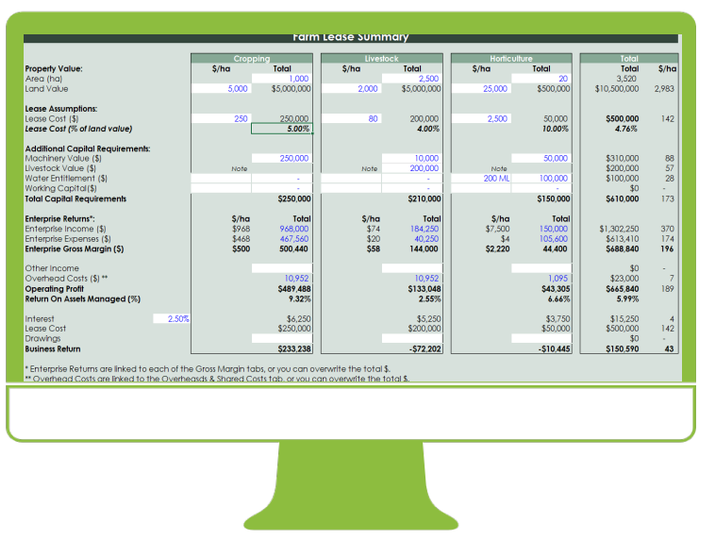
1 Percentage of market land value of the leased land

Leasing rates are commonly based on percentage of land value. NSW DPI state that although there is no prescriptive method, generally lease values are reasonably stable between 5–9% of land value. For example, if land is valued at $2,500/ha and the agreed rate is 6% of the land value, the rental payment would be $150/ha.

Farm Agribusiness Solutions noted that lease values for grazing, dryland farming and irrigated farming generally range between 5-9%, 5-9% and 10% respectively.

As land prices continue to rise, lease prices do as well! It is therefore imperative you complete your lease budget and use different methods of valuation to ensure how the land value compares to the earning capacity of the land. This is important as percentage of land value is not necessarily tied to profitability as land values are increasing at a higher rate then farm income per hectare.

Be sure research recent land sales or chat to an agent about land with similar land characteristics to arrive at a realistic land market value.



Farm Lease Summary

		Cropping		Livestock		Horticulture		Total	
Property Value:		$/ha	Total	$/ha	Total	$/ha	Total	Total	$/ha
Area (ha)			1,000		2,500		20	3,520	
Land Value		5,000	$5,000,000	2,000	$5,000,000	25,000	$500,000	$10,500,000	2,983
Lease Assumptions:									
Lease Cost ($)		250	250,000	80	200,000	2,500	50,000	**$500,000**	142
Lease Cost (% of land value)			***5.00%***		***4.00%***		***10.00%***	***4.76%***	
Additional Capital Requirements:									
Machinery Value ($)			250,000		10,000		50,000	$310,000	88
Livestock Value ($)		Note		Note	200,000	Note		$200,000	57
Water Entitlement ($)			-		-	200 ML	100,000	$100,000	28
Working Capital ($)			-		-		-	$0	-
Total Capital Requirements			**$250,000**		**$210,000**		**$150,000**	**$610,000**	173
Enterprise Returns*:		**$/ha**	**Total**	**$/ha**	**Total**	**$/ha**	**Total**		
Enterprise Income ($)		$968	968,000	$74	184,250	$7,500	150,000	$1,302,250	370
Enterprise Expenses ($)		$468	467,560	$20	40,250	$4	105,600	$613,410	174
Enterprise Gross Margin ($)		**$500**	**500,440**	**$58**	**144,000**	**$2,220**	**44,400**	**$688,840**	**196**
Other Income								$0	-
Overhead Costs ($) **			10,952		10,952		1,095	$23,000	7
Operating Profit			**$489,488**		**$133,048**		**$43,305**	**$665,840**	189
Return On Assets Managed (%)			**9.32%**		**2.55%**		**6.66%**	**5.99%**	
Interest	2.50%		$6,250		$5,250		$3,750	$15,250	4
Lease Cost			$250,000		$200,000		$50,000	$500,000	142
Drawings								$0	-
Business Return			**$233,238**		**-$72,202**		**-$10,445**	**$150,590**	43

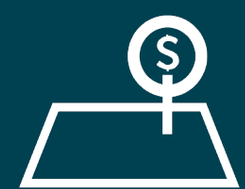
* Enterprise Returns are linked to each of the Gross Margin tabs, or you can overwrite the total $.
** Overhead Costs are linked to the Overheads & Shared Costs tab, or you can overwrite the total $.

Example:

If land is valued at $4,000/hectare and the agreed percentage value is 6%, then the lease value would be $240/hectare (4,000 * 0.06).

If you are leasing 500ha from the owner the annual lease payment would be $120,000 (240 x 500) or $360,000 over a three year period.

Please be aware some agreements build in an indexing rate for inflation, so this number would be understated.



2

3

Percentage of expected gross margin (or operating profit)

Also referred to as 'the budgeting method', this principle is based on the lease value reflecting a percentage of the potential returns achieved on the leased land.

DPI NSW suggest percentages based on 25% of expected gross margin from cropping and a long term agistment rate for livestock (i.e. $1/DSE/week for sheep and $10/hd/week for a dry cow. GRDC use a rate of 30% as they note this tends to be economically viable for many farmers and provides adequate incentive for the landowner.

However, despite these suggested percentages, we must stress that the percentage of expected gross margin (or operating profit) you may want to achieve depends on your personal factors and individual goals set when entering this lease (along with your risk appetite!).

Consider:

- How much of my operating profit is retained after paying my lease? Am I aiming for 5% or 10%?
- How will my capital position have changed having had the lease? Have I built up my assets in livestock or machinery?
- Do I have other financing commitments (e.g. interest) that I also need to cover out of my operating profit?

The Lease Calculator can help you budget these figures! It is designed to help you understand your income, costs, gross margin and potential returns.

Example:

- Total lease area: 500ha
- Sheep: 500 hd (wethers)
- Wheat sown: 150ha
- Barley sown: 150ha

Using crops at 30% of Gross Margin income and livestock at a long-term agistment rate:

- Sheep: 500 hd @ $1/DSE/week (52 weeks) = $26,000
- Wheat: $450/ha (GM) x 30% x 150ha = $20,250
- Barley: $470/ha (GM) x 30% x 150ha = $21,150

Total lease payable = $67,400 per annum or $135/ha

When compared to the market value approach, this approach calculates a lease payment reduction of approximately 40% less.

- Leasing and Share Farming Land Fact Sheet (GRDC)
- Leasing Land - calculating a rental (NSW DPI)
- How do I calculate a fair leasing rate for Agricultural Land? (Farm Agribusiness Solutions)
- Leasing Property calculator (People in Dairy)

XLSX

The Lease Calculator (developed by Agripath for the Young Farmer Business Program) is designed to help you work through calculating a lease value.

It can be used to work out your expected gross margins and returns, or if you already know these figures, you can enter these yourself.

XLSX

NSW GOVERNMENT Department of Primary Industries

Young Farmer Business Program

This factsheet was prepared by Airlie Landale (Farm Table) for the Young Farmer Business Program with the assistance of Agripath.