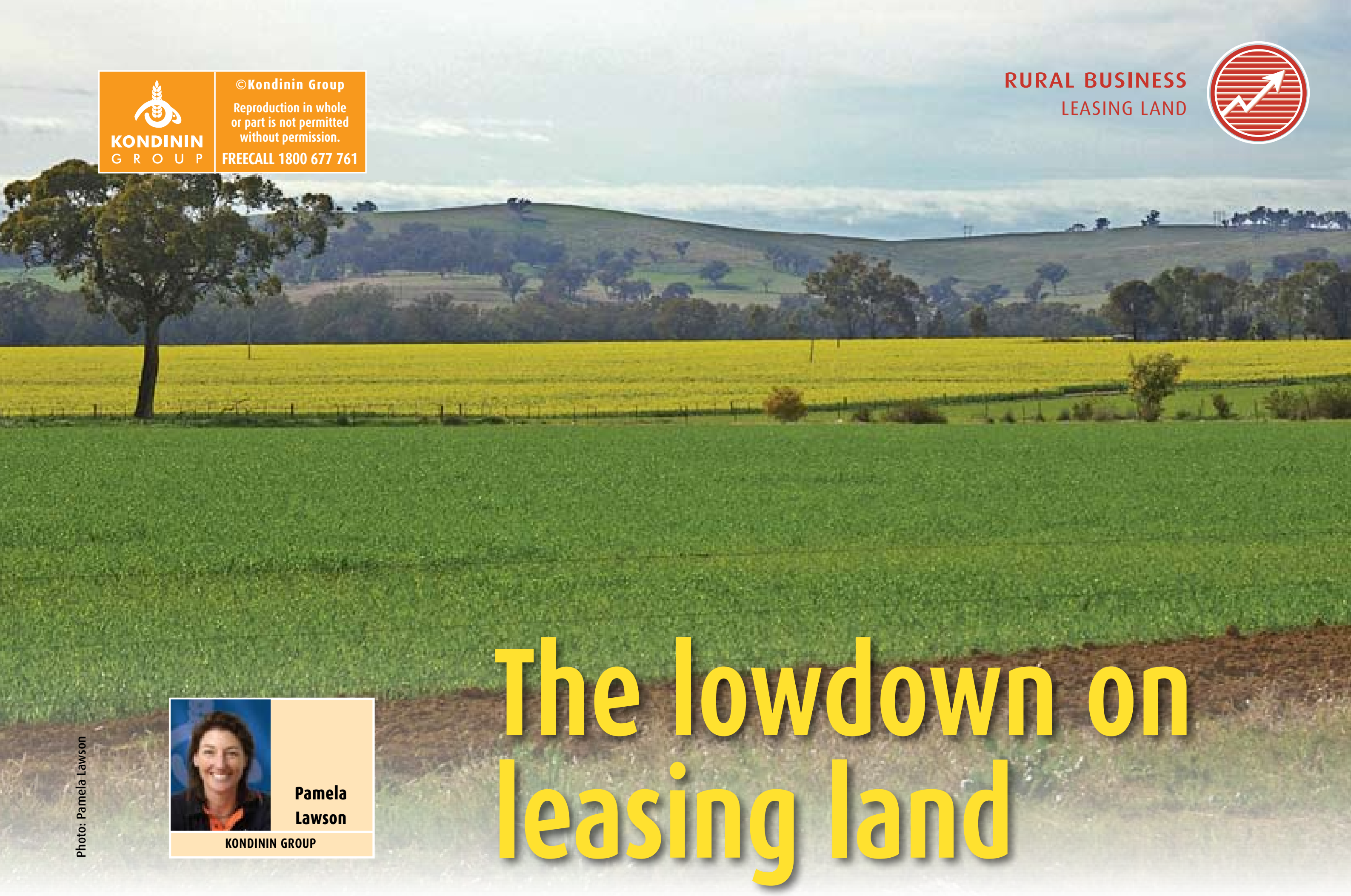

Photo: Pamela Lawson

The lowdown on leasing land

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Cropping content: *Lease agreements vary in terms and conditions and may include details such as the minimum proportion of legumes or oilseeds to be included in the rotation.*

If the season is favourable, leasing broadacre cropping country, in particular, can be profitable for both the lessor (the landholder) and the lessee (tenant). This article looks at the typical terms and conditions for both the lessor and lessee covered under a leasing contract, how to calculate a fair rent and some unusual conditions that may need to be considered.

The leasing of privately owned land is done on a relatively small scale in Australia, with only six per cent of farm land leased compared to 35% in the United Kingdom and up to 50% in the United States.

But lease arrangements can be very attractive and profitable for all parties involved. The lessee gets the full benefit of their own labour and management skills and can use their money to buy resources such as livestock, fertiliser and machinery rather than spending it on capital costs such as land and permanent infrastructure.

Leasing a small block is often a great stepping stone for new farmers to gain farming experience, at a relatively low cost, before deciding the type and size of farm to buy.

Similarly, farmers leasing neighbouring or land in their local area are likely to achieve economies-of-scale for less money than buying land.

The lessor has the benefit of receiving a known, set income over the length of the lease regardless of the seasonal conditions or production outcomes from the land. They can ensure the land is cared for under certain conditions as described in the lease agreement and do not have to invest money in income-producing resources such as livestock and machinery. A lease arrangement can be especially beneficial for people who have recently purchased land that is remote to their place of residence or who are inexperienced farmers. Alternatively, the next generation of a farming family may not be ready to take over the farm from those wanting to retire from farming, so leasing offers the retirees retained ownership, income from their asset, potential capital appreciation of their asset and no labour requirements.

Contractual conditions

A lease agreement should always be in writing to ensure both parties understand their rights and responsibilities and to reduce the likelihood of disputes. A solicitor should be consulted before entering a lease agreement and both the lessor and lessee need to be clear about the standard requirements that make the agreement legally binding. These may include the condition that the agreement is not made under threat or undue pressure by either

At a glance

- Leasing land can be a low cost way to start-out in farming or as a tool to increase economies of scale.
- A lessor benefits through having a set income regardless of seasonal conditions, retaining asset ownership and capital growth and setting the conditions under which the land is maintained.
- Lease agreements vary in conditions and terms so it is wise to obtain legal advice when entering a lease arrangement.
- Lease rent can be calculated using a percentage of the land's market value and verified by looking at the potential returns from the lease.

party and all important facts about the land have been accurately disclosed.

Each lease agreement will include unique, specific conditions, many of which are outlined in the boxed section on page 11. There should also be the provision for an independent agricultural consultant to assess the condition of the property pre-lease and to form a report that can be reviewed by the consultant each year. Alternatively, a video or photographs can be taken before the lease starts, particularly of the improvements and facilities. The greater the restrictions on the lease, the less rental charged on the proposed lease area. This includes the lease requirement of noxious pest and weed extermination rather than just control.

Opting in or out

Most leases run for between 3–5 years, to encourage the tenant to look after and make improvements to the land which they will benefit from during the time of the lease. Many leases are set-up as three, three-year terms, with the lease rate reviewed at the end of each three-year term.

If the lease agreement includes the option to renew, there needs to be a set amount of time that the tenant must give as notice to the landlord if they intend to take up the next lease option.

If there is no option to renew and the land has the potential to be sold during or immediately after the lease period, in some States such as Victoria, the tenant can request that any lease exceeding three years is registered with the Register of Titles so it appears on the land title. This means the lease continues if the land is sold during the lease period.

If the lease is not registered, more security for the tenant will be gained if there is a clause in the lease saying it will be automatically renewed unless six or 12 months notice is given by either party.

Table 1 shows the lengths of notice that must be given by either party to terminate various types of tenancies. If the land is sold, a tenant wanting to keep leasing needs to start negotiating as early as possible with the new buyer.

TABLE 1 Notice required to terminate tenancies

Tenancy type	Period of notice required*
Fixed term (of any specified length)	None. Terminates at the end of the fixed term.
Period tenancy (other than year-to-year)	Equal to at least the length of the term.
Year-to-year tenancy	At least six months notice prior to the end of the current period.
Sharefarming agreements	If the sharefarming agreement is for crop growing, one month's notice after the end of the current annual cropping programme. For other cases, at least one month's notice.

* This table does not allow for a breach of tenancy or where a different notice period has been agreed by both parties in the lease agreement.

Source: NSW DPI, Primefact 338

Fair rate: *A benchmark leasing rate range for agricultural land is between 3–9% of land market value. This can be verified by calculating the likely returns from the land by using, for example, 25% of the total expected gross margin income from cropping.*

Allocating responsibilities

Agricultural tenancies of greater than one hectare for land being used wholly or mostly for agricultural purposes are covered by the *Agricultural Tenancies Act 1990*. Details of this Act can be found on the NSW DPI website (www.dpi.nsw.gov.au/aboutus/about/legislation-acts/agricultural-tenancies). This allows for compensation to be claimed for certain improvements carried out by the tenant, with or without the landholder's consent.

Similarly, a landholder can claim compensation in certain circumstances for the deterioration of the property during the lease period.

In general, the tenant will pay for all the lease agreement preparation fees (each party pays their own legal fees), all property operating costs including water usage, the lease rental, Livestock Health and Pest Authorities rates in NSW, public liability insurance and any repairs and maintenance required to keep fixtures in their current condition. The landholder will pay local authority rates and charges, crown rent and insurance on improvements. These conditions will vary with every lease agreement but need to be perfectly clear in the agreement when the lease starts.

If major repairs to fixtures are required, the landholder could hire a tradesperson, pay the tenant for their labour to fix it or insure the fixture for future repairs with this cost covered by the rent payments.

If the repair constitutes an improvement, the landholder will usually provide the materials and the tenant the labour. A lease agreement may include adjustments to the rent if specific improvements are made by the tenant. It may also allow tenants to take certain new infrastructure such as a water trough with them at the end of the lease period, otherwise they must leave behind any improvements that are not legally removable.

A fair rent

Rents for leasing agricultural land vary according to the location and productivity of the land and what it is to be used for. In general terms, a fair rent needs to provide the landholder with a reasonable rate of return on their land and enable the tenant to earn a reasonable income in an average year, after covering their expenses.

A prospective tenant must take into account the value of their labour, working capital and management skills when working out how much rent they can afford to pay.

The traditional benchmark leasing rate range of agricultural land is 5–7 per cent of the market value of the land for land that includes basic fences and watering facilities. Many State Governments use the broader range of 3–9% of land market value, with land used for grazing commanding a rent at

Production based: *Land leased for grazing usually commands a rent at the lower end of the land market value range and may be better negotiated on a dollars per dry sheep equivalent basis.*

the lower end of this range and land used for cropping or closer to regional centres at the higher end. Leased irrigation land usually attracts a higher rental (about 10% of land value) as there is more certainty in the return on investment, although the prospect of water shortages must be taken into account.

For the lessee, lease payments are fully tax deductible, nor are payments deemed to be primary production income for the lessor for the purpose of income averaging for tax.

Checking calculations

Some grazing leases may be better negotiated on a 'dollar per dry sheep equivalent ($/DSE)' basis to better reflect actual earning capacity of the land rather than using a real estate value. The NSW Department of Primary Industries advocates a budgeting method that can be used to verify that lease rents are appropriate, based on calculating a percentage of the potential returns from the enterprises to be carried out on the leased land. The suggested amounts to be used are 25% of the total expected gross margin (GM) income from cropping and a long-term agistment rate of 20 cents per DSE per week. When these expected returns are tallied, the total amount should be comparable to the calculated rent using the percentage of land market value method. Local stock and station agents can also usually advise on fair rents for properties in the area.

Purchase option

The offer of a lease with the option to buy by a landholder attracts a higher rate of rent (often 10–15% of land value) as the lessee has the chance to buy the land at the end of the lease period at a predetermined price. This higher rate gives the landholder wanting to sell some insurance against the tenant not buying the land at the end of the lease period.

Some leases allow for the difference between the benchmark fair lease rate for the district and the higher actual lease rate to be taken off the purchase price, but this must be clearly stated in the initial agreement.

The recent fall in interest rates has made leasing rather than selling land (with or without the option to buy) more enticing for landholders, as returns from leasing now exceed other forms of investment. But low interest rates also make purchasing land more attractive, if finance can be secured, so the demand for lease land may decrease while interest rates remain low.

Including buildings

In most leases, the landholder retains the right to occupy or lease out the house. If it is included in the lease agreement, a small additional charge may be added to the rent. There also needs to be clauses in the lease pertaining to the house, addressing issues such as repairs, rent increases, privacy, termination or eviction notices and dispute resolution.

Houses on land that is being leased for grazing, agistment or farming are usually not covered under State Residential Tenancies Acts. FA

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- www.dpi.nsw.gov.au/__data/assets/pdf_file/0017/104093/leasing-land-calculating-a-rental.pdf
- www2.dpi.qld.gov.au/sheep/6846.html

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Alternatives to leasing

Share-farming:
- Both parties carry some risk
- Most common for cropping enterprises
- Traditional 50/50 profit split where the landholder provides the land, seed and superphosphate, the tenant provides plant and labour and they evenly split freight, pest control and nitrogen fertiliser costs.
- Higher input costs and greater climate variability has meant people are looking at 70/30 or 75/25 profit splits, especially if the landholder provides land only.

Hybrid model:
- A flexible, rain-based lease arrangement, in effect, the leasing of growing season rainfall.
- Both parties accept some seasonal risk, the tenant accepts all the management risk.
- Requires growing season rainfall to be costed at, for example, 54 cents per millimetre, to calculate per hectare lease payments

Joint venture:
- Landowner provides land, on-farm management and implementation.
- Joint venturer provides livestock, working capital and management expertise for day-to-day operations.
- Lower return to landholder than leasing but provides a guaranteed minimum payment and proportional share of profits.
- Suitable for family succession situations as the younger generation get to 'trial farm' and the older generation maintains a minimum income and primary producer tax advantages.

Factors to consider when leasing land

- **The condition** of the property and fixtures being offered for lease, and how they will be left at the end of the lease.
- The rental rate and term of the lease.
- Insurance requirements.
- Dispute resolution involving an independent agricultural consultant to minimise cost.
- Maximum amount of area that can be cropped.
- Details of the crop rotation including the minimum proportion of legumes or oilseeds in the rotation.
- Nutrient balance that must be maintained in the soil including lime and fertiliser requirements (seek advice from local agronomists).
- Pasture establishment requirements, especially following or during the last cropping phase.
- Noxious pest and weed control requirements.
- Maximum stocking rate.
- Stocking policy during droughts.

Source: Adapted from NSW DPI Primefact 338