English Contract Farming Agreement

Harvest 2016 (provisional results) and Harvest 2015 (final results) | Spring 2017

At a glance

RECEIPTS AND COSTS

Total receipts are expected to average £1,157/hectare (ha) in 2016 - about the same as in 2015 but below the five year average.

Receipts are lower due to the combination of weak commodity prices and lower yields.

Variable costs are expected to fall to £413/ha in 2016, continuing their fall since 2012. However, they remain higher than five years ago.

INCOME

The average income to the farmer is expected to be £311/ha in 2016 - higher than in 2015 but 22% lower than in 2014.

The average income to the contractor is expected to be £319/ha, which is in line with 2015 results but lower than the five-year average.

LONG-TERM PERFORMANCE

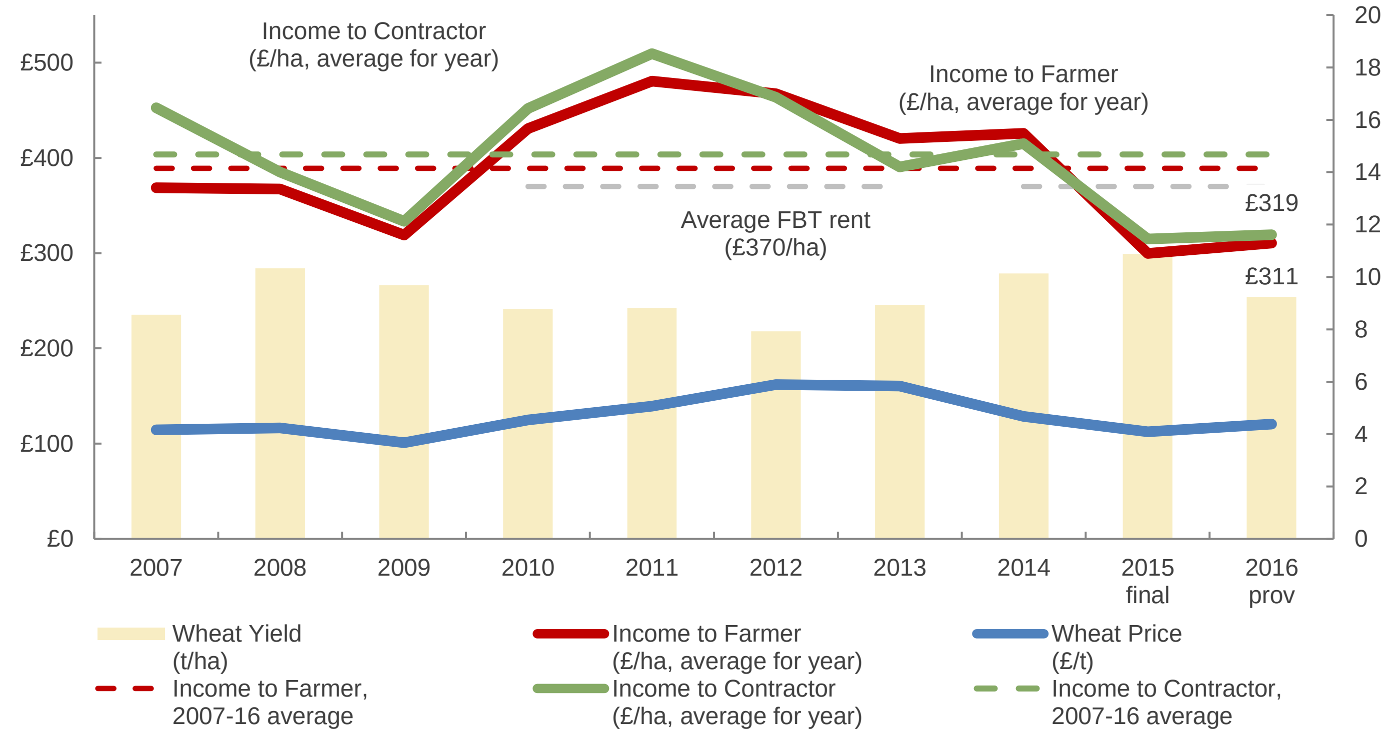
Since 2007 farmers have received an income comparable with a typical rent for a 3-5 year Farm Business Tenancy (CFA £388/ha average v rent £370/ha).

Farmers have paid an average income to their contractor of £403/ha since 2007, which is around £50/ha lower than a typical power, machinery and labour cost of £450/ha for a cereal farm.

If this saving is added to the income to the farmer, the benefit to the farmer increases to £438/ha.

Chart 1

CFA performance 2007-2016



Market overview

How income and risk to farmers and contractors is changing

The income earned by both farmers and contractors from contract farming agreements (CFAs) remains under pressure, according to the provisional results for 2016. This is due to lower yields at harvest 2016 – typically 15% lower than in 2015, although around the five-year average – and despite slightly higher commodity prices.

The way CFAs usually operate means both farmers and contractors earn less when farming is less profitable. However, contractors have been more protected during the downswing by a rise in the contractor's charge – from £230-240/ha five years ago to £270 now. This has meant that the proportion of their income that is fixed - earned through the contractor's charge - has increased, from 50-60% to over 80% now.

Farmers have also become more reliant on the farmer's retention for their income than before – but this is solely due to lower profitability, as the trend over time has been for farmers to take increasing amounts of the risk (and the return). This is shown by the proportion of the first split of income payable to the farmer increasing from 31% of the divisible surplus (2009 – 2013 average) to 41% (2014 – 2016 average).

So the data over time shows contractors are now getting a higher element of fixed income (from the contractor's charge). So too are the farmers at the moment (from the farmer's retention), but they will get more risk-based variable income when farming becomes more profitable.

Renegotiations, new agreements and tenders

The trend identified above is continuing in renegotiations and new agreements, with terms offering the contractor greater certainty about their income from a CFA through a higher contractor's charge than we might previously have seen.

We have also seen greater joint-working by farmers and contractors, with both parties looking at opportunities to boost income or cut costs. Approaches include taking the least profitable or most challenging areas out of production, as well as re-examining how crops are marketed.

In terms of new tenders, contractors are bidding at around the same levels as in 2016 (@£260-280/ha contractor's charge in the East of England / Midlands for combinable cropping), on the basis that they know Basic Payment Scheme payments have been guaranteed until 2019 and commodity prices have risen since the referendum vote.

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About the survey and definitions

This is a survey of the financial performance of CFAs managed by Strutt & Parker's farming department in England. The survey results are produced by our farming department and Dr Jason Beedell of our in-house research team.

It includes the detailed financial results of 51 CFAs covering 13,300 hectares (32,900 acres) in 2016, and our database includes the annual financial performance of 374 CFAs since 2007, so is one of the most comprehensive sets of data. The farms are mainly located in the East of England, East Midlands and South East England.

The 2016 provisional results are based on estimates of crop yields and financial performance as at 1 December 2016. We will produce final results based on actual yields, income and costs in late 2017.

The sample of CFAs varies between years, as there are some new agreements and as some end. In order to check whether changes in the sample are affecting the overall results, results from 15 agreements for which we have data for 2013, 2014, 2015 and 2016, which represent a 'frozen sample', have been compared with the overall results. They are not significantly different from those for the whole sample which gives us confidence that the trends we are reporting are real.

The survey only includes land that is used for arable and root crop production. It does not include any livestock farming. Basic Payments and Entry Level Stewardship payments (if the land is in the scheme) are included in receipts. Land in Higher Level Stewardship agreements is treated on a case-by-case basis, depending on whether the scheme payments are handled within the CFA or not.

Note on average calculations and the problem of averages of averages

The figures shown in the tables are the average for all of the CFAs for each measure, such as variable costs. This method produces figures that are the most reflective of reality but they do not 'sum' precisely (i.e., receipts less costs does not precisely equal net margin), which would involve 'summing' the average of averages, and that causes lots of problems!

Data sources

The survey uses data from a number of sources. Feed wheat price is based on the average of S&P managed farms, selling on an intelligent basis with usually 30%-50% sold before harvest. The farms have reasonable storage and selling at harvest is avoided where possible. Wheat yield is based on S&P's Harvest Yields Survey results, which for 2016 includes actual yields from 129 farms covering 54,000 hectares managed by our farming department. The farms are mainly in the East of England, East Midlands and South East England. The typical power, machinery and labour cost of £450/ha for a cereal farm is based on typical costs used by S&P's farming department.

What is a Contract Farming Agreement?

It is an agreement, or joint venture, between a landowner or tenant, referred to as the farmer, and a contractor to farm an area of land. Both parties retain their individual business identities and trading positions for tax and VAT purposes. The agreement sets out the duties of the farmer and contractor, and how any income and expenditure is to be shared.

Who does what?

The farmer, who can be an owner or a tenant, provides land and buildings.

He engages the contractor to provide services to grow crops, such as sowing the crop, spraying, fertilising and harvesting it. Any crops grown are the property of the farmer.

The farmer continues to be active and makes management decisions about how the land is farmed, and provides input into budget setting. He usually remains responsible for meeting cross-compliance rules.

The contractor provides labour, machinery, management expertise and can provide additional buildings if needed.

What are the benefits of a Contract Farming Agreement?

The farmer can reduce the amount of physical farm work done and the amount of working capital, for machinery and labour. They can also be attractive to non-farmers who have invested in farmland but have little farming experience.

The farmer remains in occupation of the farm, and so can enjoy living there and benefits like shooting over the land.

The agreement does not create a tenancy over the land or a partnership with the contractor, and so the farmer keeps the tax benefits of being a trading farmer. Any income that he or she receives from the agreement is amalgamated with any other farming activities.

The agreement should generate higher and more stable income than in-hand farming as the farmer benefits from the contractor's lower labour and machinery costs, and their experience and expertise. The agreement should also incentivise the contractor to be as efficient as possible.

Compared with a tenancy, the farmer has more control over farming practices that could lead to weed or pest problems, such as blackgrass and potato cyst nematode.

The contractor farms more land without having to buy it or enter into a tenancy agreement, both of which may require higher levels of working and long-term capital and risk.

The contractor can increase his or her income if the agreement incentivises the contractor to be as efficient as possible.

The contractor should, like the farmer, benefit from economies of scale by spreading machinery and labour over a larger area of land.

How a contract farming agreement works

CFAs usually start in the autumn, before crops are sown.

Usually, the farmer opens a new bank account, often called a contract account, to keep all of the income and expenditure related to the agreement separate from his or her other business or private costs and income. This account is used to pay the following costs, and all income and costs included within the agreement go through it:

Variable costs, such as:

- Seeds
- Fertilisers
- Sprays

Fixed costs, such as:

- Crop drying and storage
- Hedge and ditch maintenance
- Agronomy
- Repairs and insurance to buildings
- Depreciation of fixed equipment
- Water and drainage rates
- Banking and administrative charges

The contractor receives a fixed / guaranteed payment from the contract account called the **contractor's charge**, often quarterly or half-yearly, to cover some of his working costs.

Following the sale of the crop and receipt of all income due, the balance left in the account, called the **net margin**, is split between the two parties according to the terms of the agreement. The farmer usually receives a payment first, called the **farmer's retention**. Any remainder is then **split** according to an agreed formula; agreements can include second and third splits, which are used to reduce or balance risk when crop markets or profitability is volatile.

Where an agreement develops over the long-term, splits can be renegotiated to reflect capital investment by either party.

What the different terms used mean

Receipts	Total gross revenue generated, which includes crop sales, Basic Payment Scheme and Entry Level Stewardship payments (if the land is in the scheme). Land in Higher Level Stewardship or Countryside Stewardship agreements is treated on a case-by-case basis, depending on whether the scheme payments are handled within the CFA or not.
Variable costs	Seeds, sprays and fertiliser.
Contractor's charge	Cost/ha for providing labour and machinery to farm the land under the agreement.
Fixed costs	Machinery, buildings and other costs that do not vary depending on the area farmed. NB Some CFAs include fixed costs such as grain storage and irrigation, while others exclude it.
Net margin	Net revenue after variable costs, contractor's charges and fixed costs have been deducted from receipts.
Farmer's retention	Cost/ha for providing the land and buildings charged by the farmer.
Divisible surplus	Revenue that is divided between the farmer and contractor after variable costs, contractor's charges, fixed costs and farmer's retention have been deducted from receipts.
First split to farmer (%)	Proportion of the divisible surplus that the farmer receives. There can be second and third splits too.
First split to contractor (%)	Proportion of the divisible surplus that the contractor receives. There can be second and third splits too.
Income to farmer (£/ha)	Total income that the farmer receives, including farmer's retention and first (and second and third) splits.
Income to contractor (£/ha)	Total income that the contractor receives, including contractor's charge and first (and second and third) splits.

Results[1]

Receipts, variable and fixed costs, contractor's charges and net margin

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015 prov	2015 final	2016 prov
Number of CFAs	24	24	29	29	27	55	40	50	45	45	51
Area (ha)	4,556	4,448	5,593	5,639	4,401	11,440	9,262	9,329	10,098	10,092	13,339
Receipts	£1,111	£1,147	£1,108	£1,302	£1,425	£1,486	£1,356	£1,387	£1,169	£1,144	£1,157
Variable costs	£241	£325	£399	£351	£375	£477	£467	£478	£447	£446	£413
Fixed costs	£78	£100	£86	£98	£90	£107	£108	£113	£110	£113	£114
Contractor's charge	£194	£203	£228	£232	£242	£241	£260	£261	£268	£273	£270
Net margin	£598	£520	£394	£621	£718	£661	£521	£535	£345	£311	£359

Total receipts

Total receipts are expected to average £1,157/ha in 2016. This is about the same as in 2015 but over £200 less than in 2014 and 2013 and also below the five year average, due to a combination of weak commodity prices and lower yields.

Strutt & Parker 2016 Harvest Yields Survey results[2]

The overall winter wheat yield for 2016 was 8.9t/ha which, although down 13% on last year's record average of 10.2t/ha, is close to the five-year average of 9.1t/ha.

First wheat yields averaged 9.2t/ha, only 1% down on the five-year average but starkly 15% down on the memorable 2015 harvest.

Second wheats averaged 8.8t/ha, which is 5% lower than in 2015, and the same as the five-year average.

Matching 2015 yield was never a reality, the season started off very slowly and for many too much rain in the latter stages of development hampered yields. Foliar disease culminated in some potential yield and quality loss through ear disease. Lack of grass weed control had a fundamental impact on yields in some areas, reducing yield through either direct competition or late season crop destruction. Overall, second wheats seemed more consistent than first wheats, possibly due to later drilling and lower disease pressure, but more likely due to higher total nitrogen use.

Oilseed rape had its lowest performing year since 2004, with an average yield of 2.9 t/ha, which is 18% lower than the five-year mean and 23% lower than in 2015.

Variable costs

Variable costs are expected to fall to £413/ha, continuing their fall since 2012, mainly due to lower spending on fertiliser. However they remain higher than six years ago, particularly for seed and spray costs. We expect spray costs to remain higher, as the battle against resistant weeds and disease has forced them up over time, from around £140/ha in 2007-09 to £190/ha now.

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Variable costs are expected to fall to £413/ha, continuing their fall since 2012.

[1] The figures shown in the tables are the average for all of the CFAs for each measure, such as variable costs. This method produces figures that are the most reflective of reality but they do not 'sum' precisely (i.e., receipts less costs does not precisely equal net margin), which would involve 'summing' the average of averages, and that causes lots of problems!

[2] Figures are from S&P's Harvest Yields Survey, which records yields from 54,000 ha, spread over 129 farms in East Anglia, the South East and the Midlands, including farms managed by the firm and where the firm has agronomy input. Click here to download a copy or contact George Badger at the Cambridge Office for a hard copy or to discuss the results.

Contractor's charge

The average contractor's charge, which is the fixed / guaranteed payment that the contractor receives to cover some of their working costs, is expected to remain around £270/ha, compared with the five and ten year averages of £261 and £240 respectively. It has risen consistently since 2007, when our survey started, from around £200/ha.

Fixed costs

Fixed costs are expected to remain stable, at just over £110/ha although there is a large variation between agreements so care should be taken when using these figures. The variation reflects whether buildings, grain drying, irrigation and machinery are included within the agreements.

Net margin

Net margin is expected to rise slightly to £359/ha, up almost £50 on 2015 levels but a third lower than in 2014 (£535) and well below the £600+/ha generated in 2010-2012.

Farmer's retention

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015 prov	2015 final	2016 prov
Farmer's retention	£220	£213	£223	£238	£237	£261	£287	£283	£291	£296	£292

The average farmer's retention has stabilised after its long-term rise, from around £210-220/ha in 2007 to around £280-290/ha now.

Divisible surplus and first splits to farmer and contractor

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015 prov	2015 final	2016 prov
Divisible surplus	£377	£321	£198	£382	£500	£399	£246	£252	£54	£15	£68
% of agreements making a negative divisible surplus[3]	0%	0%	0%	0%	0%	0%	5%	12%	38%	47%	33%
First split to farmer (%)[4]	24%	27%	27%	29%	32%	32%	36%	39%	43%	43%	41%
First split to contractor (%)	76%	73%	73%	71%	68%	68%	64%	61%	57%	57%	59%

The divisible surplus is expected to recover slightly from 2015 lows but remain at very low levels, at £68/ha; it has only been below £200/ha twice before.

A third of the CFAs are expected to produce a negative divisible surplus in 2016, compared with about half in 2015, 12% in 2014 and 5% in 2013.

The first split to the farmer has been rising, to around 40%, up from around 25-30% in 2007, and the first split to the contractor has done the inverse and so has fallen from 70-75% to around 60% in 2015. This 'balances' the rise of the contractor's charge - with the overall split of income between farmer and contractor remaining broadly similar since 2007 (see below).

[3] i.e., these are agreements where the farmer 'takes' the negative divisible surplus, so reducing the expected farmer's retention.

[4] NB These figures exclude agreements where there is a negative divisible surplus as, due to the way most agreements are structured, the farmer bears all of a negative divisible surplus, so the first split changes to 100% to the farmer.

Income to the farmer and to the contractor

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015 prov	2015 final	2016 prov
Income to farmer	£369	£367	£319	£431	£481	£467	£421	£419	£326	£300	£311
Income to contractor	£453	£385	£333	£452	£509	£464	£391	£408	£317	£315	£319
Income to farmer (%)	46%	49%	48%	49%	49%	50%	52%	46%	49%	44%	48%
Income to contractor (%)	54%	51%	52%	51%	51%	50%	48%	54%	51%	56%	52%

The average income to the farmer is expected to be £311/ha in 2016, up slightly on 2015 but below the five-year average of £383/ha. Compared with a rental equivalent (for a three to five year FBT rent of £370/ha (£150 per acre)), the farmer made more money in good years but less in bad years over those five years.

The average income to the contractor is expected to be £319/ha in 2016, again below the five-year average of £379/ha and the average since 2007 of £403/ha.

For farmers, the amount paid to contractors is less than a typical power, machinery and labour cost of £450/ha for a cereal farm, and so is a good way of reducing these fixed costs on their farms.

In well-structured agreements, both sides should be incentivised by the same outcomes – producing high yields, controlling costs and meeting the farmer's objectives for sustainable land management.

> *The average income to the farmer is expected to be £311/ha in 2016, up slightly on 2015 but below the five-year average of £383/ha.*

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Chester	01244 354 888
Chichester	01273 832 602
Cirencester	01285 659 661
Edinburgh	0131 226 2500
Exeter	01392 215 631
Farnham	01252 821 102
Gerrards Cross	01753 891 188
Guildford	01483 306 565
Harpenden	01582 764 343
Harrogate	01423 561 274
Haslemere	01428 661 077
Horsham	01403 246 790
Inverness	01463 719 171
Ipswich	01473 214 841
Lewes	01273 475 411
Ludlow	01584 873 711
Market Harborough	01858 433 123
Moreton-in-Marsh	01608 650 502
Morpeth	01670 516 123
Newbury	01635 521 707
Northallerton	01609 780 306
Norwich	01603 617 431
Odiham	01256 702 892
Oxford	01865 366 700
Pangbourne	0118 984 575
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