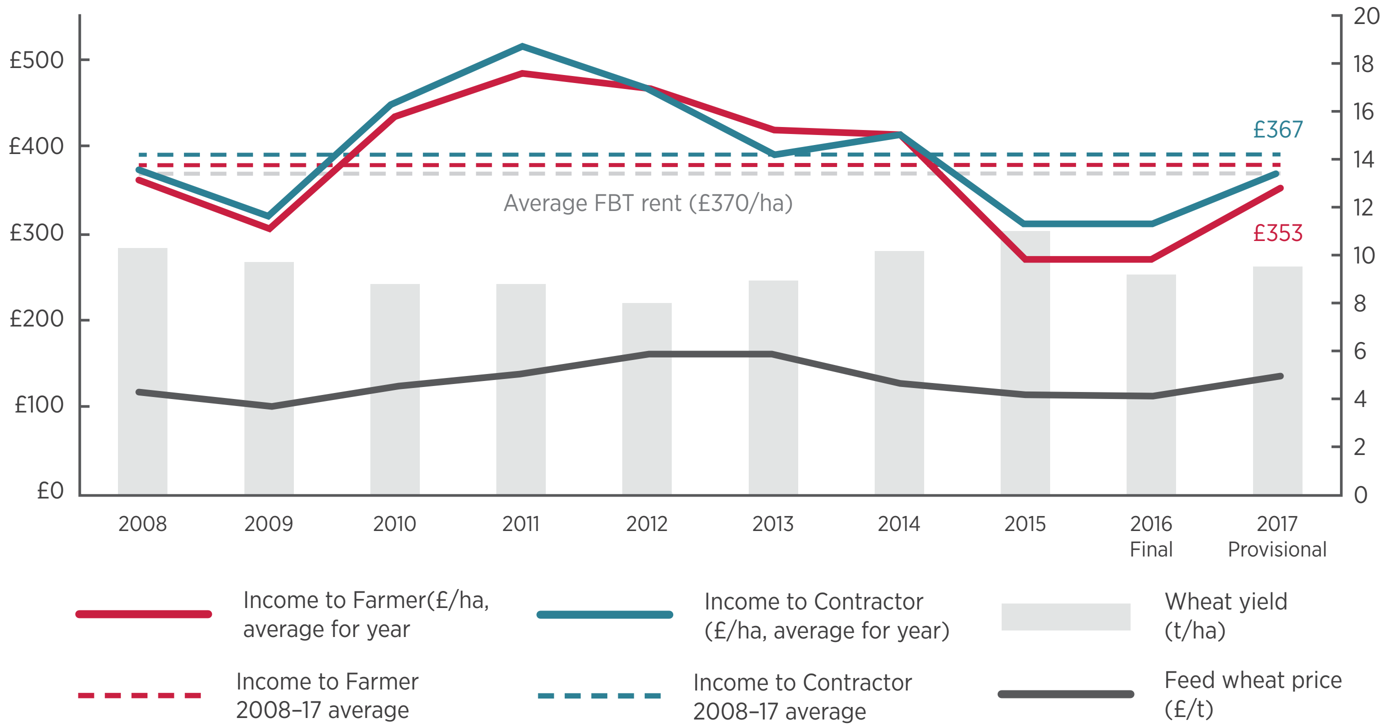
English Contract Farming Agreement Survey

Harvest 2017 (provisional results) and Harvest 2016 (final results) | Spring 2018



Market overview

The improvement in income to both farmers and contractors is the result of a £103/ha increase in receipts compared with 2016, which is due to a more favorable exchange rate improving crop prices.

Variable costs for the 2017 crop were the lowest since 2011, a product of reduced fungicide expenditure due to the dry 2017 spring and the replacement of failed oilseed rape with lower input crops, such as spring barley and spring oats.

Farmers have absorbed the low returns in recent years, receiving less than the contractor on average. The survey results identify a trend of contractors receiving a higher contractor's charge, which is fixed, and lower first split of the divisible surplus. This shift of risk has protected the contractor from volatility in receipts from crop sales.

Continued overleaf.

At a glance[1]

Receipts and costs

Expected receipts in 2017 are higher than in 2016 from crop sales, Basic Payment Scheme and Entry Level Stewardship payments (if the land is in the scheme), due to slightly higher commodity prices and yields.

Variable costs have fallen slightly due to growing conditions in spring 2017.

Income

Income to the farmer is expected to be £353/ha (average for year), which is around the five-year average, but there is a wide variation (from under £200 to near £600).

Income to the contractor is expected to be £367/ha, recovering from the lows of 2015 and 2016, but still below the 10-year average.

Long-term performance

Contract Farming Agreements (CFAs) are giving farmers an income that is comparable with a 3-5 year Farm Business Tenancy (of around £370/ha (£150/ac) rent), at lower power, machinery and labour costs than a typical cereal farm (of £420-440/ha) plus retaining the tax advantages of being a trading business.

[1] All figures are for CFAs that are arable only agreements (i.e., exclude agreements with root crops) apart from the new section on agreements with root crops from page 7.

Market overview

Continued from page 1

We expect receipts to become even more volatile in the future for a number of reasons:

- The ban on outdoor use of neonicotinoids will increase crop yield variability due to pest exposure.
- Basic Payments, which are currently the most 'fixed' element of receipts, are likely to be reduced from 2019-20 onwards as the Government implements the proposed change in support from area based payments to 'public money for public goods'. The reduction may be greatest on large farms if capping is introduced.
- Finally, receipts from the new generation of agri-environment schemes (called the Environmental Land Management Scheme) may make up some, but probably not all, of the reduction in Basic Payments. It is not clear what the basis of these payments will be and they could be more variable than current agri-environment payments if (partially) based on environmental outcomes.

Given this, both farmers and contractors are likely to want to review their agreements to reassess the division of income and risk, as well as establishing incentives for high quality environmental management, which could become as important as high quality crop management.

Renegotiations, new agreements and tenders

The shift to higher contractor charges is continuing, with any divisible surplus split equally between farmer and contractor.

This continues a trend of contractors reducing risk and farmers bearing a greater proportion of the risk, which stems from volatility in commodity markets.

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 in-house research team.

The provisional figures for harvest 2017 include the detailed financial results of 71 CFAs covering 18,600 hectares (46,100 acres), and our database includes the annual financial performance of 553 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 2017 provisional results are based on estimates of crop yields and financial performance as at 1 December 2017. We will produce final results based on actual yields, income and costs in late 2018.

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 14 agreements for which we have data for 2013, 2014, 2015, 2016 and 2017, 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. This year we have reported on the results for agreements that include root crops separately, as they have different revenue and cost profiles. All figures in this report are for CFAs that are arable only agreements (i.e., exclude agreements with root crops) unless explicitly stated. Agreements with root crops are shown in a separate section from page 8.

The income, or receipts, for a CFA include crop sales, Basic Payments and Entry Level Stewardship payments (if the land is in the scheme). 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 can produce an unrealistic figure which is misleading.

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 2017 includes actual yields from 132 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 £420-440/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 drilling 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, rotation planning and sale of produce. He 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. CFAs can also be attractive to new 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 the benefits of the farming lifestyle. The agreement does not create a tenancy over the land or a partnership with the contractor, and so the farmer keeps the 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

Arable 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 • Fertiliser • 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, often called the divisible surplus, 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 are volatile.

Where an agreement develops over the long-term, splits can be renegotiated to reflect 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 agreements is treated on a case-by-case basis, depending on whether the scheme payments are handled within the CFA or not. NB Some farmers retain the Basic Payment from their land and exclude it from their CFA; we have added it back into our figures so that they give an accurate picture of the total income a farmer receives.
Variable costs	Seeds, fertiliser and sprays.
Contractor's charge	Cost 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 charged by the farmer for providing the land and buildings, often set per hectare.
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.

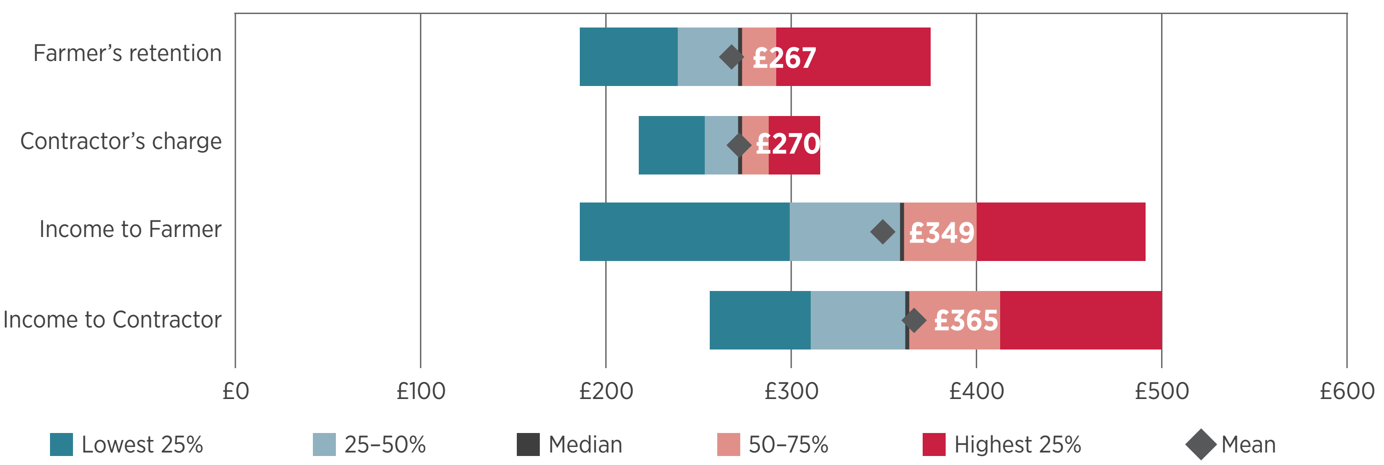
Results for arable agreements (excluding agreements with root crops)

- Higher receipts expected (from crop sales, BPS and Entry Level Stewardship payments), due to higher crop prices.
- Contractor's charge slightly higher but around five-year average.
- Higher income expected to both farmer and contractor – back to around the five-year average.

Figure 1 **Receipts, costs and income to Farmer and Contractor from arable agreements**

Annual averages (£/ha unless otherwise stated)[2]	2008	2009	2010	2011	2012	2013	2014	2015	2016 Final	2017 Provisional
Number of CFAs	22	27	27	26	51	35	40	36	49	54
Area (ha)	3,278	4,424	4,469	4,123	9,470	6,257	6,261	6,009	8,973	10,776
Receipts	£1,122	£1,078	£1,300	£1,441	£1,483	£1,358	£1,388	£1,101	£1,101	£1,204
Variable costs	£327	£401	£350	£382	£486	£481	£494	£458	£416	£391
Fixed costs	£91	£82	£94	£88	£96	£97	£101	£95	£104	£103
Contractor's charge	£199	£226	£230	£243	£242	£263	£265	£277	£265	£269
Net margin	£505	£368	£627	£727	£658	£517	£528	£271	£316	£441
Farmer's retention	£207	£219	£234	£235	£258	£283	£275	£281	£247	£273
Divisible surplus	£313	£174	£393	£512	£401	£248	£253	-£10	£68	£168
% of agreements making a negative divisible surplus	0	0	0	0	0	6	15	53	39	11
First split to farmer (%)[3]	28	28	30	33	33	37	42	48	42	45
First split to contractor (%)	72	72	70	67	67	63	58	52	58	55
Income to farmer	£361	£307	£435	£484	£466	£419	£413	£269	£273	£353
Income to contractor	£374	£317	£453	£517	£464	£390	£410	£308	£311	£367
Income to farmer (%)	49	48	49	49	50	51	44	42	46	49
Income to contractor (%)	51	52	51	51	50	49	56	58	54	51

Figure 2 **Range of returns to the Farmer and Contractor from arable agreements (2017 provisional) (£/ha)[4]**



[2] 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 can produce an unrealistic figure which is misleading.

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

[4] To present the range of performance of typical CFAs, the highest two and lowest two performing agreements have been removed from the figures as they can distort the range; therefore the means differ from those presented in other figures in this report.

Figure 3 **Average of Farmer's retention and divisible surplus to the Farmer from arable agreements (2008–2017 provisional) (£/ha)**[5]

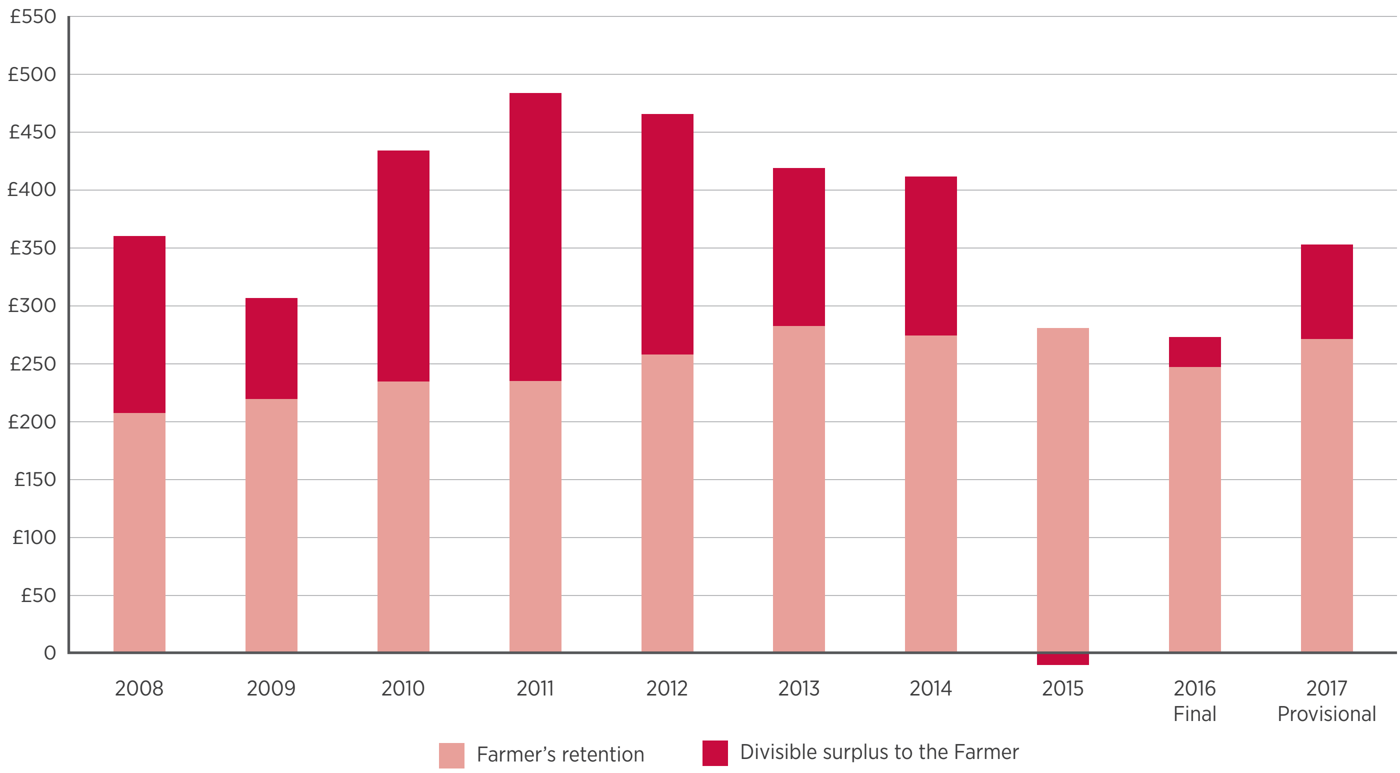
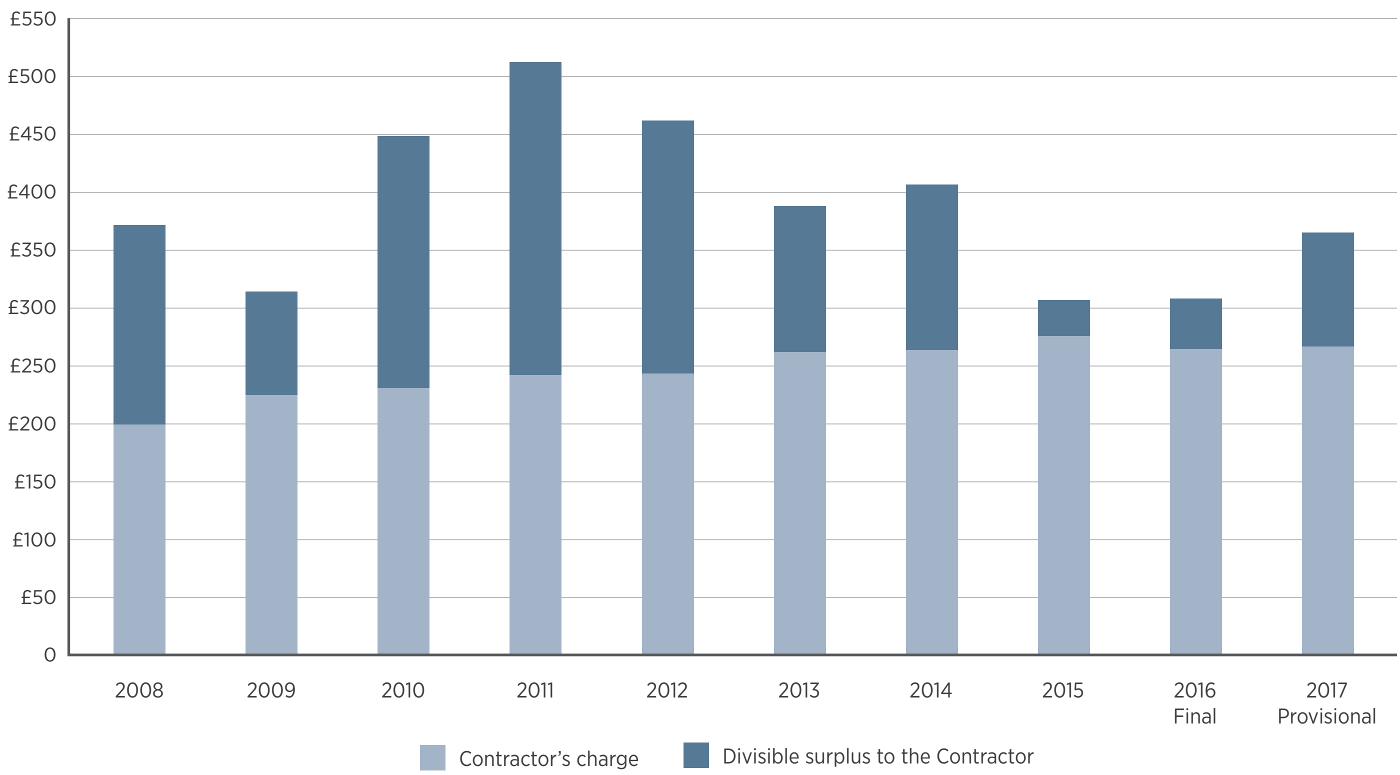


Figure 4 **Average of Contractor's Charge and divisible surplus to the Contractor from arable agreements (2008–2017 provisional) (£/ha)**



[5] In 2015, the divisible surplus is negative for farmers but positive for contractors as 19 of the 36 CFAs had negative divisible surpluses, which were allocated entirely to the farmer, but 17 had positive divisible surpluses, which were allocated between the farmer and contractor.

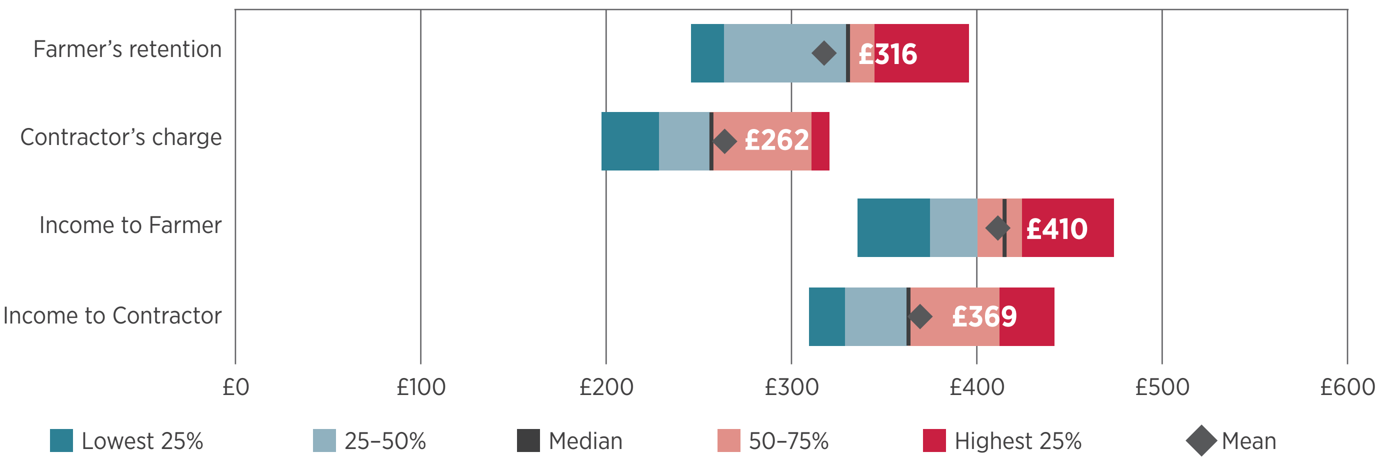
Results for agreements including root crops

• Slightly higher receipts expected but just below the five-year average.
• Contractor's charge reduced slightly and now below five-year average.
• Higher income for 2017 expected to both farmer and contractor compared with 2016.

Figure 5 **Receipts, costs and income to Farmer and Contractor from agreements including roots**

Annual averages (£/ha unless otherwise stated)[6]	2013	2014	2015	2016 Final	2017 Provisional
Number of CFAs	5	6	9	14	17
Area (ha)	3,005	2,512	4,084	6,838	7,867
Receipts	£1,338	£1,570	£1,316	£1,218	£1,294
Variable costs	£367	£441	£397	£363	£372
Fixed costs[7]	£178	£197	£187	£153	£142
Contractor's charge	£240	£280	£259	£268	£256
Net margin	£552	£651	£472	£433	£524
Farmer's retention	£317	£381	£356	£365	£331
Divisible surplus	£236	£269	£116	£68	£194
% of agreements making a negative divisible surplus	0	0	22	36	6
First split to farmer (%)[8]	24	28	31	36	43
First split to contractor (%)	76	72	69	64	57
Income to farmer	£429	£512	£421	£387	£418
Income to contractor	£394	£449	£340	£316	£364
Income to farmer (%)	52	54	55	54	53
Income to contractor (%)	48	46	45	46	47

Figure 6 **Range of returns to the Farmer and Contractor from agreements including roots (2017 provisional)[9]**



[6] 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 can produce an unrealistic figure which is misleading.
[7] Fixed costs for these agreements are higher than for agreements without roots as they include specialist contracting operations.
[8] These figures exclude agreements where there is a negative divisible surplus as, due to the way agreements are structured, the farmer bears all of a negative divisible surplus, so the first split changes to 100% to the farmer.
[9] To present the range of performance of typical CFAs, the highest two and lowest two performing agreements have been removed from the figures as they can distort the range; therefore, the means differ from those presented in other figures in this report.

Figure 7 **Average of Farmer's retention and divisible surplus to the Farmer from agreements including roots (2008–2017 provisional) (£/ha)**

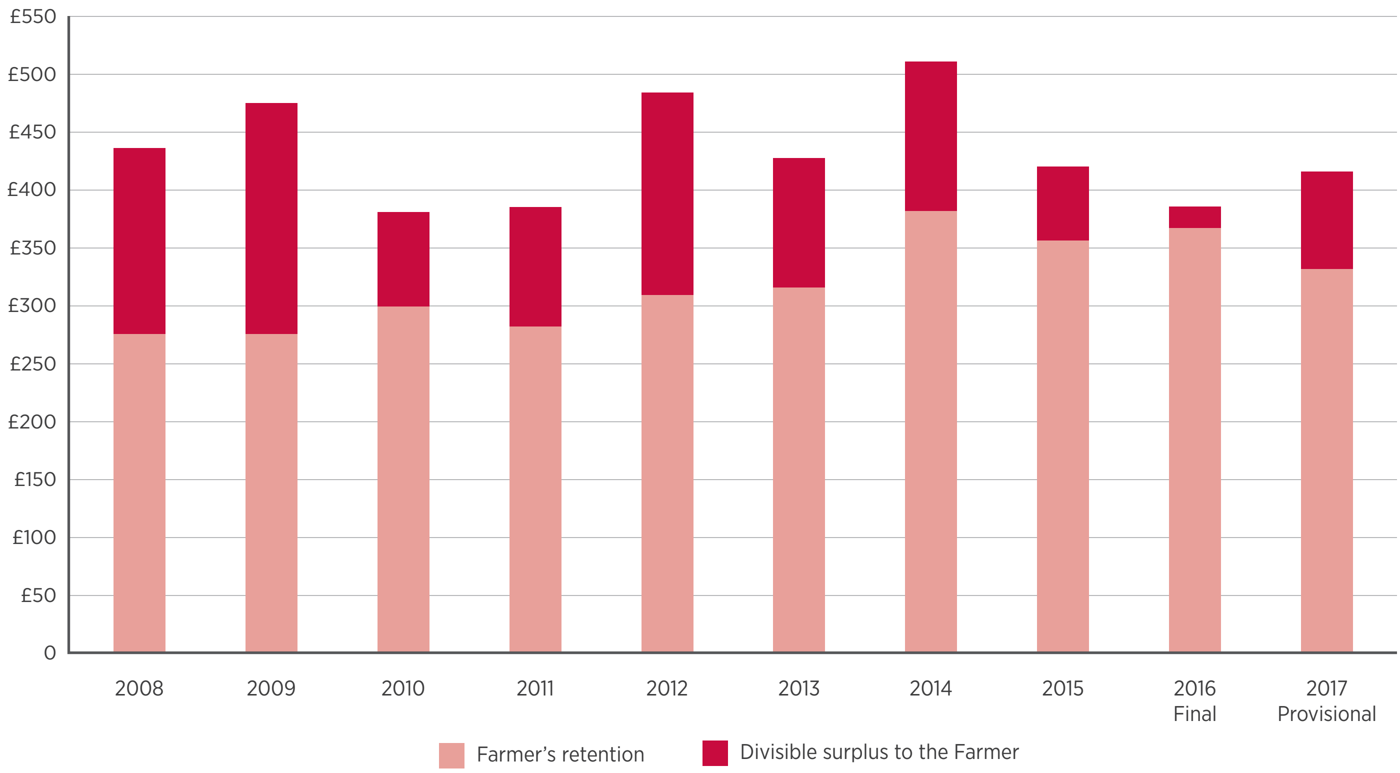
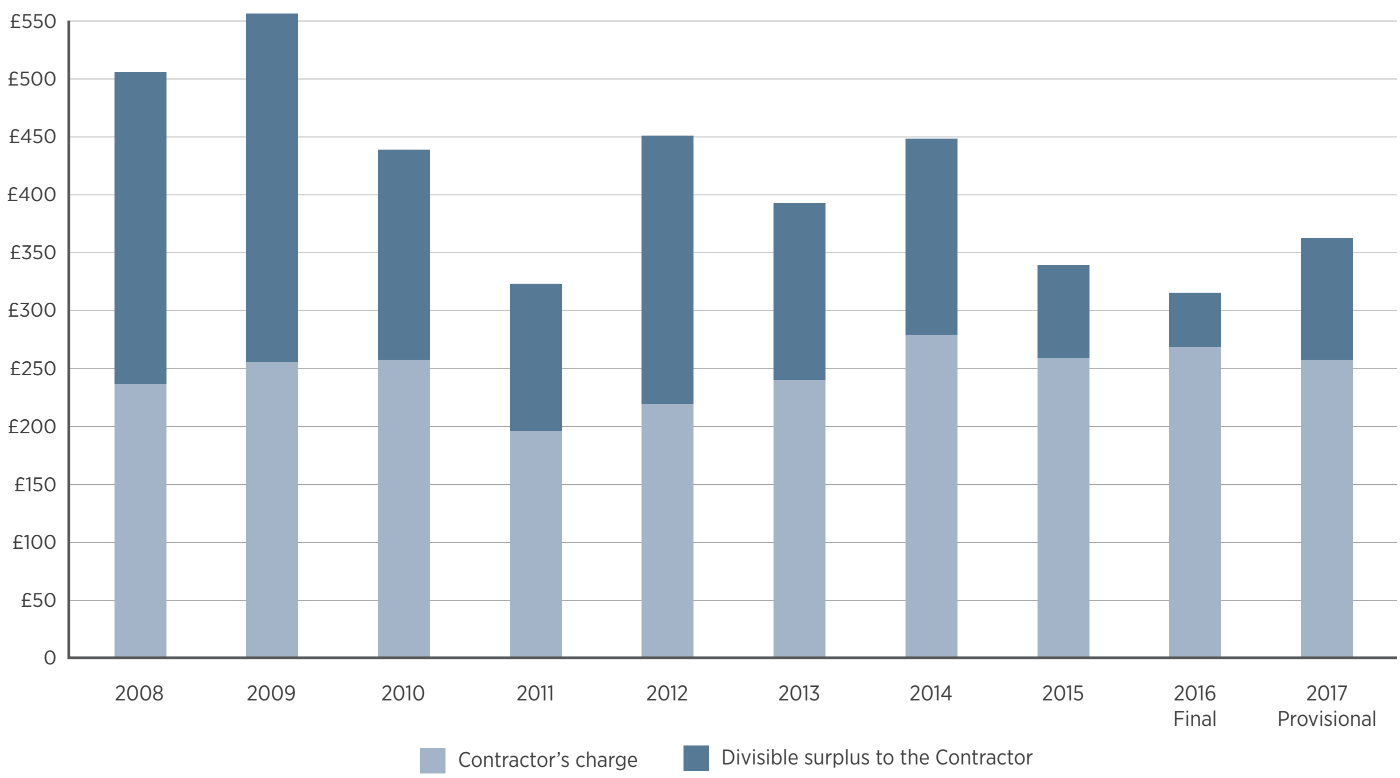


Figure 8 **Average of Contractor's charge and divisible surplus to the Contractor from agreements including roots (2008 – 2017 provisional) (£/ha)**



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