# Equity partnership in a land owning farm business

## What is it?

Equity partnership in an entity that owns the farmland. In many cases this entity will also own other key assets such the herd, machinery and dairy company shares.

## Background

Equity partnerships can be a successful way for both the progressing farmer to invest and build equity, and for the existing farm owner to free up equity and retain good management, or as part of a farm succession process. The existing land owner can invite a progressing farmer to invest in their farm business or in some cases seek to purchase a new farm together. The business is valued and shares purchased at the agreed rate. Typically, the progressing farmer would also operate the farm as a variable order sharemiker, contract milker, or a manager as well as being an investor in the farm.

## Advantages and considerations

**Advantages**

- This option is a good way to encourage a good progressing farmer to become part of the business.
- Helps to align the drivers of success for both the person(s) managing the farm and the farm owner.
- Frees up equity for the existing farm owner.
- Given land prices typically fluctuate less rapidly than cow prices, there may be less asset value risk compared to investing in a HOSM venture.
- Capture the historical trend of capital gains.
- Banks will lend a higher ratio against land in comparison to livestock. This enables a higher degree of financial leveraging to occur.

**Considerations**

- Progressing farmers should be aware of their returns from the farm business. Investing in a farm business may provide lower returns on investment that other progressing options such as HOSM or a farm lease.
- Requires a good working relationship between both parties, as do all agreements.
- Lack of management control for a progressing farmer, compared to farm leases or other options.
- Cash returns are relatively low compared to HOSM and other models.
- Exit from this arrangement can be more difficult.

## Keys to success

- A clear equity partnership agreement must also be drawn up which explains how farm management decisions will be made, who has final say on farm management decisions and the exit process.
- For progressing farmers, selecting a farming business they see as progressive and able to help them grow is critical. Choosing the right equity partner can significantly grow your business, just as the wrong equity partner may ultimately hold you back.
- Equity partnerships should generally focus on agreed profit and cashflow objectives, rather than relying on the potential for capital gain.

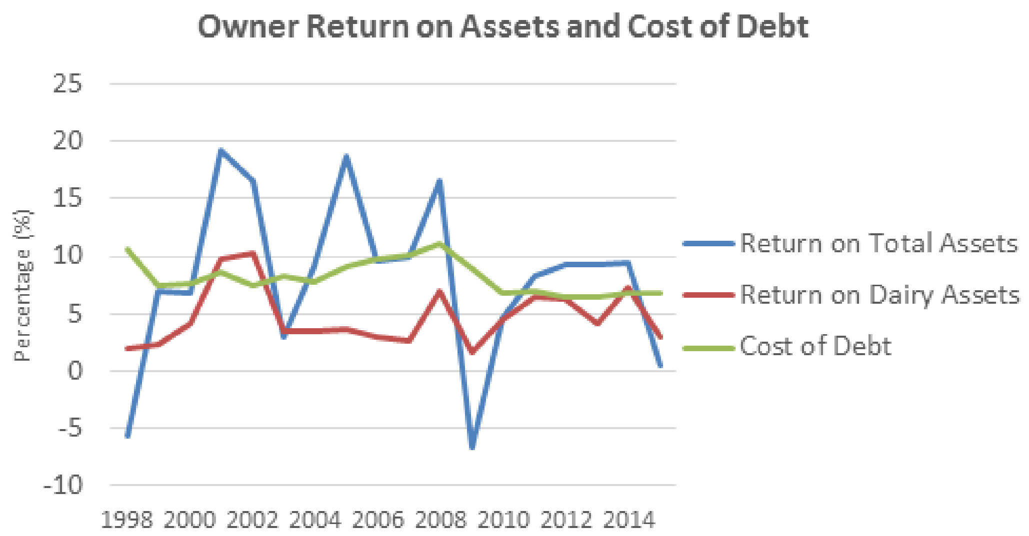
- Undertake due diligence on both the potential business/farm and the potential partners.
- Good communication and governance throughout the duration of the agreement.
- Clear understanding of the business goals, management plan and measures of success for the business.

## Financial

The returns from an equity partnership would reflect any standard owner operator model divided between shareholders (e.g. 20% of profit plus 20% of capital growth) if assets included land, herd, machinery, plant, buildings, and shares.

Typically, the key driver of the business is profitability leading to greater return on investment. This business structure does generally result in an alignment of drivers within the group. It is important that a clear policy around dividend payments is agreed upon.

The average return on total assets (including the change in value of the cows and capital value in land) over the 10-year period from 2005-2015 was 7.1%. However, the returns vary significantly from year to year as shown in the graph below.




*Source: AgFirst (total assets includes cow values and change in capital value of the land)*

If the equity partnership is for land only, then the returns may be similar to lease agreements with shareholders receiving a share of the lease rental.

For example: for land valued at $40,000/ha a rental of $1,600/ha offers a 4% cash return. A rental at $1,540/ha in our previous example where infrastructure was included gives returns of 3.9% (excludes any additional capital gains). Total rent per annum would be $192,000 and $184,800 respectively.

Return on investment can vary significantly depending on the farm management ability, timing of entry and exit, quality and value of the land asset purchased.

## Entry/exit process

- Clear business timeframe with the entry and exit process specifically outlined: this needs to include the exit process if one party needs to exit before the end of the timeframe.
- A clear policy around the valuation of the business at the start and end of the agreement.