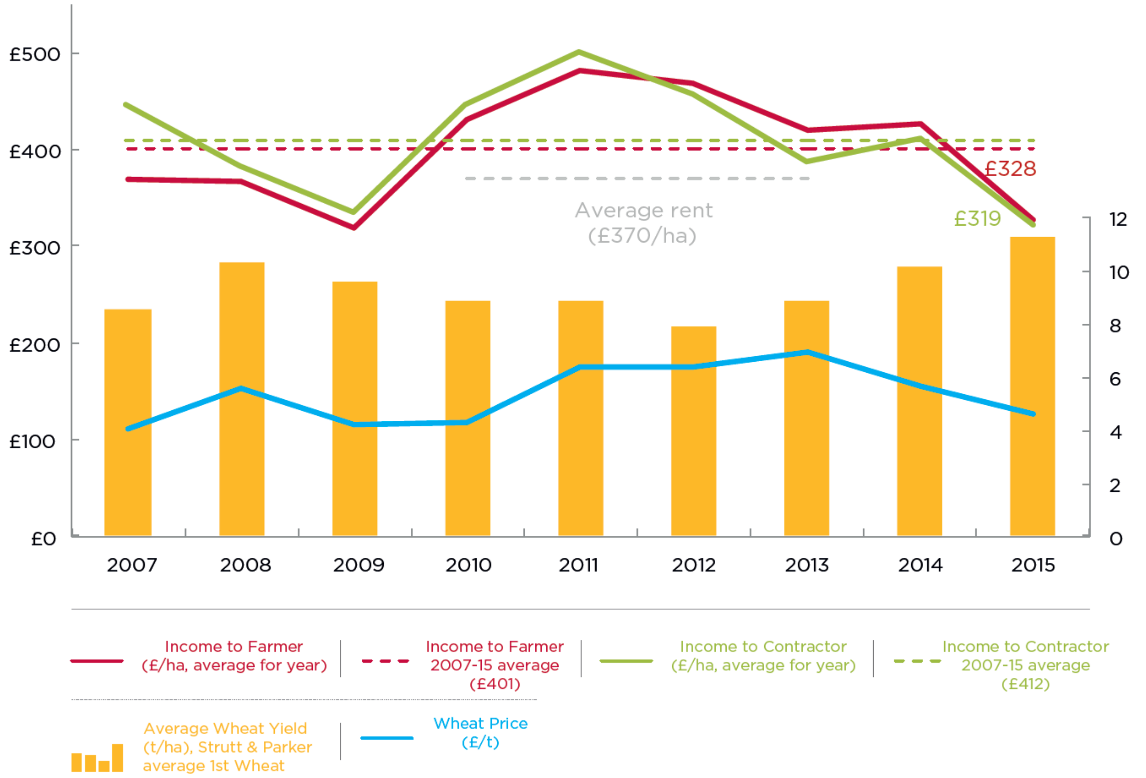
English Contract Farming Agreement Survey
June 2016

Harvest 2015 (provisional results)[1]

Headline results: Low commodity prices see incomes drop by 23% in 2015



- The income for farmers and contractors from Contract Farming Agreements fell by nearly a quarter in 2015 due to lower commodity prices and despite crop production costs being cut.
- Big yields were insufficient to fully offset lower commodity prices.
- Commodity prices fell by 19% which caused gross income per hectare to fall by 17% to £1,175 per hectare, the lowest since 2009.
- Although variable costs (seed, spray and fertilisers) reduced by 8% to £447 per hectare, their lowest level for four years, it was not enough to offset the lower commodity prices. In addition, despite the reduction, variable costs remain above the 2007-15 average of £397 per hectare.
- The average income to the farmer was £328 per hectare in 2015, 23% lower than in 2014 and the second lowest in our survey.
- The average income to the contractor was £319 per hectare, which is the lowest in our survey.
- However, farmers continue to benefit from needing lower working capital. Farmers have paid an average income to their contractor of £412 per hectare since 2007, which is over £150 per hectare lower than a typical power, machinery and labour cost of £575 per hectare for a cereal farm. So this difference can also be added to the income to the farmer to reflect the full benefit of contract farming agreements.
- Looking at the long-term performance of Contract Farming Agreements since 2007, farmers have received an income slightly above a typical rent for a 3-5 year Farm Business Tenancy (£401 per hectare average v £370 rent per hectare (£150 per acre)) while retaining active involvement, management control as well as trading status and the associated tax benefits this brings.

[1] These provisional results are based on estimates of crop yields and financial performance as at 1 May 2016. We will produce final results based on actual crop yields and financial performance in August / September 2016.

About the survey and definitions

This is a survey of the financial performance of Contract Farming Agreements (CFAs) 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 44 CFAs covering 10,044 hectares (24,800 acres) in 2015, and our database includes the annual financial performance of 318 CFAs since 2007, so is one of the most comprehensive sets of data in England.

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 and 2015, which represent a 'static sample', have been compared with the overall results. They are not significantly different from those for the whole sample.

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 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 contract farming agreement or not.

What is a Contract Farming Agreement?

It is an agreement, 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 are to be shared.

Who does what?

Farmer:	**Contractor:**
The farmer, who can be an owner or a tenant, provides land and buildings. The farmer 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 as well as input purchasing and output marketing strategies. He usually remains responsible for meeting cross-compliance rules.	The contractor provides labour, machinery, fuel, management expertise and can provide additional buildings if needed.

What are the benefits of a Contract Farming Agreement?

To Farmer:	To Contractor:
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

Contract farming agreements 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:

Variable costs, such as:

- Seeds
- Fertilisers
- Sprays and pest control
- Agronomy
- Crop drying and cleaning
- Haulage
- Any other costs relating to crop production, such as hedging and ditch maintenance

Fixed costs that are included within the agreement, such as:

- Repairs and insurance to buildings and fixed plant used by the agreement
- Water and drainage rates
- Banking and administrative charges for the agreement
- The contractor's charge

All income and costs included within the agreement go through the contract account.

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 crops 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. The divisible surplus is then split but there can be second and third tier splits too, which are often used to reduce or balance risk when crop markets are 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 Payments and Environmental Stewardship payments (if applicable).
Variable costs	Seeds, sprays, fertiliser and other costs that vary depending on the area farmed.
Contractor's charge	Cost per hectare for providing labour, machinery and fuel to farm the land under the agreement.
Fixed costs	Repairs to fixed equipment, buildings and other costs such as professional fees that do not vary depending on the area farmed. NB Some Contract Farming Agreements include fixed costs such as grain storage and irrigation, while others exclude it.
Farmer's Retention	Cost per hectare 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 tier splits too.
First Split to Contractor (%)	Proportion of the divisible surplus that the contractor receives. There can be second and third tier splits too.
Income to Farmer (£/ha)	Total income that the farmer receives, including farmer's retention and first (and second and third tier) splits.
Income to Contractor (£/ha)	Total income that the contractor receives, including contractor's charge and first (and second and third tier) splits.

Detailed results

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
Number of CFAs	24	24	29	29	27	55	40	46	44
Area (ha)	4,556	4,448	5,593	5,639	4,401	11,440	9,262	8,773	10,045
Receipts	£1,111	£1,147	£1,108	£1,302	£1,425	£1,486	£1,356	£1,412	£1,175
Variable Costs	£241	£325	£399	£351	£375	£477	£467	£487	£447
Fixed Costs	£78	£100	£86	£98	£90	£107	£108	£114	£110
Contractor's Charge	£194	£203	£228	£232	£242	£241	£260	£267	£269
Net Margin	£598	£520	£394	£621	£718	£661	£521	£544	£348

The average total receipts in 2015 were £1,175 per hectare, which is less than in 2014 and 2013 and also below the five year average. Although yields were higher, receipts fell due to lower commodity prices.

Variable costs fell in 2015 after rising in the previous two years, due to a combination of falling seed, fertiliser and spray costs. However they were still higher than they were five years ago, particularly for seed and fertiliser costs. Although spray costs fell slightly in 2015, the battle against resistant weeds and disease has forced spray costs up, from around £140 per hectare in 2007-09 to £190 per hectare now.

The average contractor's charge was £269 per hectare in 2015 compared with the five year average of £256. It has risen consistently since 2007, when our survey started, from around £200 per hectare. It is the fixed / guaranteed payment that the contractor receives to cover some of their working costs.

Fixed costs remained stable, at £110 per hectare in 2015 although there was a large variation between agreements (the highest fixed costs in 2015 were £514 per hectare and the lowest £32 per hectare) so care should be taken when using these figures. The variation reflects whether buildings, grain drying and storage, irrigation and machinery are included within the agreements.

The net margin fell to £348 per hectare, which is a third lower than in 2014 (£544 per hectare) and the lowest level recorded since the survey started in 2007 and well below the £600+ per hectare generated in 2010-2012. Only three CFAs have made a negative net margin in the database of 318 results - and two of these were in 2014 and 2015.

Farmer's retention

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Farmer's Retention	£220	£213	£223	£238	£237	£261	£287	£289	£292

The average farmer's retention has stabilised after its long-term rise, from around £210-220 per hectare in 2007 to around £280-290 per hectare in 2015.

Divisible surplus and first splits to farmer and contractor

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Divisible Surplus	£377	£307	£171	£382	£481	£399	£234	£255	£56
First Split to Farmer (%)	24%	27%	28%	29%	33%	32%	40%	45%	61%
First Split to Contractor (%)	76%	73%	72%	71%	67%	68%	60%	55%	39%

The divisible surplus fell by almost 80% from £255 per hectare to £56 per hectare, which is the lowest level since the survey started in 2007. It has only been below £200 per hectare once before and 16 of the 44 CFAs (a third) produced a negative divisible surplus (compared with 6 in 2014 (13%) and 4 in 2013 (10%)).

The first split to the farmer continued to rise, to around 60%, 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 40% 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).

Income to the farmer and to the contractor

Annual averages (£/ha unless otherwise stated)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Income to Farmer	£369	£367	£319	£431	£481	£467	£421	£426	£328
Income to Contractor	£453	£385	£333	£452	£509	£464	£391	£415	£319
Income to Farmer (%)	46%	49%	48%	49%	49%	50%	52%	46%	49%
Income to Contractor (%)	54%	51%	52%	51%	51%	50%	48%	54%	51%

The average income to the farmer was £328 per hectare, below the five year average of £420 per hectare. However, compared with a rental equivalent (for a three to five year FBT rent of £370 per hectare (£150 per acre)), the farmer made more money in good years and less in bad years.

The average income to the contractor was £319 per hectare, again below the five year average of £420 per hectare and the average since 2007 of £412 per hectare. This is around £150 per hectare lower than a typical power, machinery and labour cost of £575 per hectare for a cereal farm.

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. Having similar objectives also reduces the risk of disputes between the parties or the contractor prioritising other land than he farms.

Strutt & Parker farming:

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Our aim is to help landowners and farmers, from the smallest through to the largest, meet their business objectives and make the most of the assets available to them.

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