Farm ownership structures for New Zealand sheep, beef and deer farms: issues and options for family owned farms

Richard and Sarah Burdon

NEW ZEALAND FARM ENVIRONMENT AWARD TRUST AND MAF STUDY SCHOLARSHIP 2009

New Zealand Farm Environment Award Trust®

MAF

Farm Ownership Structures for New Zealand Sheep, Beef and Deer Farms

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MAF – New Zealand Farm Environment Award Trust Scholarship 2009

An annual scholarship partnership programme between MAF and the NZFEA Trust has been established for a farmer to study and report on an issue that will add value, stimulate debate and promote the improvement of long term sustainability of New Zealand farms.

The Trust is extremely grateful to MAF for this scholarship, which provides our top farmers with this opportunity to provide insights on sustainability back to the farming community.

The scholarship is presented to a past Supreme Winner from the Ballance Farm Environment Awards programme.

Richard and Sarah Burdon were chosen as the 2009 Scholarship awardees.

Richard and Sarah farm Glen Dene Station, which occupies most of the land between Lake Hawea on the east, Lake Wanaka on the west, the neck to the north and stretching out to the Lake Hawea camping ground.

The property currently carries 15,000 stock units, predominantly merino sheep and 1900 deer, with cattle complementing the deer and sheep operations.

The topic Richard and Sarah have chosen to study is:

Farm Ownership Structures for New Zealand Sheep, Beef and Deer farms - Issues and options for family owned farms

This report is intended to stimulate thought on the often complicated issues farmers face when considering Farm Ownership Structures and Farm Succession Planning.

It is a farmer perspective based on Richard and Sarah Burdon's, understanding and knowledge of these issues, based on personal experience and supported by helpful advice.

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1. Overview

The topic Sarah and Richard have chosen to study is 'Farm ownership structures for New Zealand sheep, beef and deer farms'. Richard and Sarah believe that while the dairy farming sector has a wide range of ownership options available, those available for sheep, beef and deer farms are limited.

Richard has been involved in developing whole farm management plans as part of a three-year sustainable farming fund project and noted that financially viable farms are more likely to achieve good environmental and conservation outcomes will be achieved. He noted that many traditional family farming units are under increasing pressure from a range of regulatory and market forces. They often lack the time to deal with these issues, capital to expand or develop their business, and tend to struggle when it comes to family succession, often ignoring it until it is too late. The importance of having a good ownership structure is an integral part of the farming business often ignored.

Seeking advice and setting up ownership structures can be expensive. Richard and Sarah have reviewed a range of ownership structures and identified a number of the options available, providing farmers with alternatives, enabling them to continue farming sheep, beef or deer, rather than taking the dairy option or selling the family farm.

They believe that ownership structures in New Zealand need to change, particularly in the sheep, beef and deer sector. For many family farms the next ten years are going to be emotional and are going to require a head and heart battle to find ways to maintain viability.

Richard is a director of Landward Management and sees that many New Zealand farmers are at crossroads with ownership, not only the family farm but also bigger corporate farms often do not have the system in place or the structures right to perform at full potential. In writing this report Richard wanted to look at all the options available so as to help farmers develop their business.

We should be led by the leaders of our industry; not by regulations imposed by those 'who are not quite sure'. (Richard Burdon)

2. Executive Summary

Richard and Sarah's current interest in the topic of farm ownership structure is because it is an issue they have grappled with themselves, and they believe that they are not alone. Glen Dene has completed a large development programme, as well as going through family succession with Richard's parents. Both required capital funding. The expansion of the business has also required ongoing capital. Richard and Sarah have looked at lots of options and opportunities available to retain the family farm and make it prosper for future generations. In doing so they realized the importance of having a good ownership structure when considering different paths.

Richard has previously been involved with MAF sustainable farming projects looking at whole farm management plans for the hill and high country, and how economic production and conservation biology can be introduced into farming systems. Through these projects Richard and Sarah became more aware that many farmers were unable to implement such plans due to lack of economic return.

Ensuring there is a good ownership structure in place is one of the key factors in the success of a farming business and protects assets for future generations, so that New Zealand farmers remain as top performers and continue to be productive, pastoral and environmentally sustainable.

Having the right ownership structure allows for the right business model to be developed and ensures there are clear guidelines and systems in place to look to the future. To use the word sustainable in our farming business we first must be economic. Managing the environmental concerns today in a farming business requires the farm to be economically sustainable first.

3. This study aims to:

- Provide information on what ownership structure options are available for sheep, beef and deer farms, so that they may look at structures that may not have previously been considered.
- Identify the critical importance of farm ownership structure and the effect it can have on the future prosperity of a business.
- Provide information to farmers, and those keen to invest in the business of farming, on the strengths and weaknesses of different structures.
- Provide information to farmers on how to protect their business through ownership structures when introducing capital investors.
- Provide farmers with alternatives they can use to improve their family farming structure, e.g. equity partners, amalgamation etc, so they can continue farming and prosper in the future.
- Add some confidence to retiring parents to hand over to young farmers.
- Provide ideas on clear control mechanisms, so that those involved in the family farm business can know exactly where they stand and know that they are all working to a common goal.
- Provide encouragement to the retiring generation to get money off the farm earlier, so that they can enjoy the benefits of both farm ownership and off farm investment.
- Provide existing agricultural advisors in the industry with new ownership structures to discuss with their clients when making future planning decisions.
- Aim to motivate young people to become more actively involved in the livestock industry and take an ownership role from a younger age.
- Highlight to the agricultural industry the range of ownership options available. For example, swapping equity between a sheep and beef business operation and a dairy operation to future proof both of their businesses.

I was never involved with a business as capital hungry as farming until I signed up with a meat company. (Richard Burdon)

4. Guiding principles towards the right farm ownership structure

Richard and Sarah felt it was important to get input from the wider agricultural industry. They involved agricultural experts and family members from dairy, sheep, beef and deer industries so that they could provide a range of views for interested parties.

The fundamental issues that came through from this group:

- The sheep, beef and deer industry has lacked financial stability in the last 20 years.
- It is never too late to collect information about your own farming business.
- Get everyone around the table and look at all the options, structures and work on the three “Cs” - cash, control and capital.
- This is a process that takes time and money. The decision making process goes through stages; making, developing and implementing.
- Your plan needs to be ‘yours’. It should be a plan that suits your property and family.
- Each farming business solution is unique.
- Obtaining professional planning, legal and accounting advice is critical.
- Communication is the key to success, but it needs to involve all parties.
- Different generation stages have different values. Each party must respect those values.
- Successful ownership structures will ideally provide a good family environment for many farmers, and should help the business become economically viable, allowing the farm to grow, develop and meet environmental goals.
- The decision to take a career in farming is generally a long-term decision and the value of time, money, life, health and happiness all need to be understood.
- Do not confuse the farming business with the family estate. The farm should be treated like a business asset and should not be confused with family assets.

The group selected were from a range of agricultural experts who all play roles in the farming business in New Zealand. Generally it is difficult to get all the answers from just one of these parties. We all need to be mindful of the different roles and skills that each party brings to the table.

This is a list of those we see as important to consider when seeking advice.

1. **Financial advisor**
2. **Accountant**
3. **Lawyer**
4. **Generation expert**
5. **Economic advisor**
6. **Farm Consultant**
7. **Spouse/Partner**
8. **New entrant**
9. **Dairy Industry**
10. **Retiring couples**
11. **Non-farming siblings**
12. **Banker**

I wouldn't recommend getting all these experts around the table at once but I would recommend you get the ones you need. (Richard Burdon)

5. Farm structures - the three 'Cs' to getting the structure right

5.1. Control

Every business needs someone in control of its operations who leads the business and takes responsibility for the day to day decisions. Control needs to be clear and understood by all parties, especially in family environments where roles are often not clearly defined.

Too often in a family farm environment people think that they are working for their family, when actually they are working for the business. Too many family farming operations have not switched from a family structure to a business structure.

Today many farms are large enough businesses to allow for some area/unit control where responsibilities can be shared.

Work through your business systems, listing them and then looking at who in your business could take over the responsibilities of that system. It could range from ensuring vehicle maintenance and service is up to date, to running the whole cropping operation for the business.

Control does not mean controlling everything. The skill in managing comes from first having control and second by being confident enough to delegate the responsibilities. Good managers should have the confidence to delegate responsibilities and control to their staff so that they can remain focussed on the business, rather than operational issues.

5.2. Cash Income

The most important aspect in a livestock farming business is the cash income generated from the business of growing grass (cash, kg/dm). Turning kilograms of dry matter (DM) into cash should be every livestock farmer's number one focus. But how many see grass as cash? Too often sheep farmers will feed a store lamb for 100 days and not make an economic return on that outlay. There is no simple model as the process relies on some complicated issues, which are either farm dependent or animal and climate related. A few ideas to think about are:

1. The proportion of feed going to growth or production vs maintenance (ie high growth rates in animals provide a better return per kg/dm eaten because a lower proportion is going to maintenance and more to growth).
2. Efficiency of converting grass to meat. Finishing bulls requires less feed to produce a kilogram on the carcass than deer.
3. Bigger finishing stock generally requires more grass to produce a kg of carcass (again higher maintenance requirement).
4. Value of product - venison $7-9/kg, sheep $4-6/kg and cattle $3-4/kg.
5. For our region September 1 through till December 31, is one growth period I really focus on ewe hogget growth rates. (This is the Errol Holgate concept I use)
6. The reason we shear sheep is not always about the value of the fleece.
7. The total kg of DM available and type of rotation and why you change the rotation during the year.

One rule of thumb that our farm advisor uses is that for finishing lambs weighing 28 – 38 kg there is a 1 c/kg margin for every dollar of buy /sell margin. For example: buy a 28 kg lamb at $60 and sell at $75 = 15 c/kg/dm gross margin.

New Zealand grass production systems are some of the most efficient in the world at turning feed into protein. However our agricultural systems are out of balance. We are unable to perform at optimal levels because of profit levels in both the wool and meat industries in New Zealand. This is an area that Meat and Wool New Zealand (now Beef + Lamb New Zealand) should be more focussed on. It is their grass roots; everything else follows.

How can you make a profit from growing grass when the focus is all in blue sky research? (Richard Burdon)

Meat and Wool needs to get back to Horizon One the New Zealand farmers business – Cash Flow -

The farming operation needs have a clear focus on sash flow (Horizon One) which we see is the engine room of any business.

Value add (Horizon Two) is a good section to focus on when cash flow is going well.

This is about how you can obtain that extra value for your product. It identifies the market segment and opportunities within those segments.

It appears to me that the industry has been in growth mode long (Horizon Three) enough; New Zealand farming been rapidly borrowing, developing and improving for the last 20 years. It's time to focus on cash flow.

New Zealand livestock farming is under enormous pressure, as poor cash flow and returns over the last 20 years have undermined many New Zealand farming operations. "Cash is King" right now. Cash flow is being measured as the most important aspect on how a farmer can finance his business.

Farmers can:

- Prepare good budgets that are achievable and keep them updated.
- Understand pasture production systems.
- Work out how much dry matter is being grown, and then utilise it as efficiently as possible.
- Understand the difference between average, poor and top performing pastures.
- Keep in close contact with bank managers.
- Develop good teams of skilled advisors to keep focussed and on track.
- Spend more time working on returns per kg DM.
- Keep working on managing margins.
- Manage climatic risk, with good irrigation systems.
- Be very careful about capital investments.
- Keep enjoying farming life and business.

Remember next time when you're driving the tractor to think of better ways to make cash, rather than spending cash.(Richard Burdon)

5.3. Capital

The capital base of New Zealand farms has created enormous wealth for many New Zealanders who have invested in agriculture in the last 100 years. Farm values may be steady at present or back on last year's highs, but long term they continue to rise the world over.

While farm input costs have risen steeply, the income from the commodities produced have not moved in sync or in accordance with either land values or input cost.

Due to the land values being so high there is a high entry price to get into the market for many New Zealanders. We need to rethink how the family farm is owned and how that structure works. We believe there are still enormous opportunities and benefits in a career in agriculture. Owning 100% of a farm is not necessarily the best option today. When you look at the amount of capital required to run a farming business, many farms have over $1 million invested just in the stock and plant.

You need to earn capital, and it comes at a cost and needs to be paid for. Working out how to pay this capital off is an important issue. We hear too many stories of high debts with interest payments being made but no principal payments.

6. Will system changes provide more long term options?

- You're an extensive hill country farmer and you need to get more finishing country. Why not amalgamate with an intensive finishing unit?
- Consider swapping equity with a dairy farm so that you can have guaranteed grazing and feed supply agreements, shared profits and better cash flow.
- You're a large deer breeding unit and need good quality finishing and replacement hinds grown out. Find a good safe down country farm. The farm systems are kept simple and each farm has clear objectives on breeding one finish.
- Consider options on breeder/store market/finisher/crop farmer.
- Consider winter lamb contracts.
- Investigate options to invest with other farmers using vendor finance or equity share to grow the business.
- Develop relationships outside your sector so that you learn how to make money from other farming operations.
- Look at reducing climate risk and then market risk.
- Keep asking your market what you could do when you supply a product, whether its beef calves, grain or wool. Find the segment in the market that can add some value to your business and develop it (something you see all top performers doing).

Richard's observations from the dairy industry

- Equity partnerships in dairy appear quite simple because they have a single clear focus 'milk production'.
- Livestock farmers need a similar clear single focus 'pasture into protein' (kg of protein per ha).
- The different stages in dairy ownership through to full ownership are rewarding and allow young people to drive their own business.

You never see many dairy farmers milking cows after the age of 50 but I see plenty of sheep farmers still working hard at 65.(Richard Burdon)

7. Do you understand the other generation?

If you ever wondered why farm succession is so difficult think of the inter-generational changes and demands of each party. Each generation has been educated, developed and had different life experiences. Every generation's experience is different, so it is often hard to understand another generation's proposed lifecycle. When working through different generations, consultants must be mindful of each.

Each generation has:

- Different work ethics
- Different perspectives on working styles and managing.
- Unique ways of viewing quality.
- Been educated differently and see technology as a threat or are very technology-literate.

In addition:

- For many today, farming is not a lifestyle or family choice. It's a business.
- Women and men are equal in farming today.
- Farmers need the 'brains and some brawn', as well as a little heart and soul.
- Having the right attitude will help.
- The ability to manage risk is a fundamental part of standard farming practice. The rewards are there but they need to be calculated and planned before being executed.
- Farming has enough challenges without adding inter-generational issues. Get it right, plan early.
- One of the most useful generation business moves is to plan to get money invested off the farm, so that the retiring generation and the next generation are not reliant on the same income.
- Planning your farm business structure should be implemented as a matter of priority.
- The communication environment needs to be open to all, and everyone should be completely open.

Money is not everything but you will require it to pay for good advice. Losing the family farm because of poor planning will cost you more than the cost of good advice.
(Richard Burdon)

From Richard's consultancy side - Landward Group:

As well as being a farmer Richard is fortunate to be involved in Landward Group. Landward Group is a multidiscipline company employing accountants, economists, ecologists and valuers, plus support staff. The group works extensively in the rural sector in management, land economics, farm environmental management, mediation, valuation, tenure review, Public Works Act actions and restructuring tasks.

It is frequently approached to complete valuations and management evaluations that, on further examination, relate not to financing and operational efficiency but to ownership structure issues. Most commonly these are issues around how a family owned farming business is operated or how a farming business should be held and managed. Often the initial request is in response to a family disagreement or even crisis. Such farms are typically characterised by being capital intensive with low marginal returns on operations but consistent capital gains reflected in land value.

This leaves a typical problem, that of being cash poor and capital rich. This may result in the funding of farming operations and lifestyle through debt or delaying consumption until the capital asset is realised. For many, seeking even a modest level of consumption, the core business may not be able to service the debt required for families and individuals to hold and maintain the farm business.

The question is how to attract venture or finance capital to the industry or maintain the existing capital in the industry, especially capital held by family interests.

Professional advisors are not in the business of telling you what you want to hear, they are paid to tell you what you need to hear.(Richard Burdon)

Current ownership structures

Many farms are held by individuals, families or family owned companies. Corporate farming operations are on the increase but they are by no means in the majority. Family owned farming companies still tend to be run within the constraints of wider family interests rather than as standalone businesses.

Structural problems

Often, even if a farm is owned by a company, shareholder managers and staff working the farm may assume entire control because of a lack of formality around governance, or the belief that off farm shareholders and directors do not require input. Conversely previously benign off farm shareholders may suddenly become interested in the operations of the farm because of competing requirements for the capital they hold in the farm asset. Competing requirements may include establishing other businesses, buying a family home, funding a matrimonial dispute or other lifestyle options.

Capital requirement and governance issues can also occur when farmers retire from active farming. If they want to maintain family ownership but also require retirement capital this can impose additional and unsustainable debt on their successors. Some farmers also find it very difficult to “retire” and continue to try to manage and overrule new management at an operational level.

We strike on occasion family managers who when held to account for operational decisions respond by saying: “If you don’t like what I am doing, either buy me out or I will sell my share.” This shows a lack of understanding of shareholding responsibilities. Good education of sound business principles and practices can lessen this risk but never underestimate the latent destructive power of intra-family rivalries, a trait not restricted to farming families.

Corporate ownership is typified by shareholders having invested capital in the anticipation of returns from a mix of dividends and capital gains. It provides an ownership mechanism where a growing market should exist for the shares held should they wish to exit. Corporate ownership structure can accommodate changing needs in a more flexible manner.

In a family company this flexibility is more difficult to attain and if a shareholder wishes to exit often the options are limited, usually by pre-emptive rights, to additional borrowing to purchase shares, the remaining shareholders assuming additional bank debt or sponsoring the introduction of approved but unrelated shareholder partners.

The answer?

There is no universal answer. Deeply rooted divisions between shareholders, especially in closely held business operations, is destructive and ultimately may result in the failure of or selling the business.

However, there are steps that can be taken to mitigate the risk of conflict and assist the farming business to survive and thrive through issues such as shareholder unrest or changes, market fluctuations, changes in farming techniques, capital demands for development projects or competing demands for capital off farm.

Shareholder capital, rather than bank debt, should provide more comfort to a well run business, but the emphasis must be placed on "well run". This emphasis includes both operational and governance performance.

Advice we have sought has always been to establish a formal structure, including scheduled regular and formal board meetings even for family owned farming businesses, even if held in trust.

Why? The answer is straight forward. Farming businesses represent significant capital assets and they need to be run as a business first and foremost.

A formal structure requires a formal approach to management and governance. We would advocate independent directors and quarterly directors meetings each year, with a management report provided in an agreed format.

Annual budgets need to be provided and capital purchase and development expenditure identified, quantified, discussed and planned for.

Farm managers should be on salaries based upon market rates. Farm managers who are family shareholders are no exception.

Personal experience is that the failure to put such managers on salaries results in inadequate financial accountability and a blurring of farm and personal expenditure that can result in unnecessary acrimony.

Alternatively a family farm manager can be underpaid and ultimately cross subsidise family member shareholders. Both are points of potential conflict.

The modern farming world needs commercial structure and discipline around operations and governance.

This is particularly necessary where ownership is by way of shareholdings and trusts, where off farm parties are involved.

It is also particularly necessary if capital, by way of shareholder investment, is to be retained or attracted to the industry and it is becoming essential for the competitive sourcing of capital from financial institutions.

Farms are multimillion dollar business assets that are capable of providing returns to shareholders from all walks of life.

Farming underpins the New Zealand economy.

With structured management and governance they are capable of serving the long-term interests of family and wider shareholding arrangements.

The alternatives to structured business arrangements and multiple shareholdings are to use debt to simplify ownership or exit the industry.

Both these choices may come at a high price for many

8. Have you done a health and wellbeing check on the farming operation?

At Landward we know the banks have changed the lending criteria and are now requiring a full project and cash flow analysis of projects.

This could be from developing an existing deer farm to adding a new woolshed or house into the farming operation.

It is likely that much more will need to be provided to the banks in the future than a cash flow projection.

Landward Management has been approached by a number of farmers to look at what we call a health and wellbeing check. This covers a range of aspects important in today's farming world.

1. A valuation of the businesses
2. An environmental assessment of the business
3. Resource management assessment
4. Economic viability report
5. Budget and cash flow projection
6. Development cost analysis.
7. Governance and financial management plan
8. Staffing structure and reporting systems
9. A review of the last three years' accounts/business result (BR)
10. Future uses and potential report
11. Land risk appraisal property (LRAP), OSH and risk analysis
12. Significant landscape amenity measure (SLAM)
13. Development cost and returns analysis
14. Human resources (HR) - have you the right mix and team?

The report you need should be short and sweet. So next time you require a consultant make your contract clear and fair otherwise you will both despair. (Richard Burdon)

9. Where do the non-farming siblings fit in?

Treating all people equally and ensuring succession is possible, but it needs good discipline and structure. There are some very good business models in Australia and New Zealand. One is where two brothers have set up a farming business together, one a lawyer the other a farmer. They have been able to grow their business and they both enjoy the benefits of economies of scale. They both enjoy the business and benefits that come with land ownership. You do not have to own 100% of a farm to get the benefits of land ownership.

Many farming families could consider setting up company structures to enable their farming operation to progress. The important rule in setting up a family farming company is for the family to remember they're working for a business, not their mother, father, sister or brother.

Farmers need to treat their family homes as separate assets to the farming business so that individual families can develop their houses and curtilage at the speed and desire they wish. Don't let the business interfere with the family.

Today, farm succession is about having the best person for the job and not about setting up the son and sending the daughters off to town. Women have always been part of the farming business and there is no reason why they should not manage the business. We have plenty of good examples in New Zealand of very good female owner/managers. The issue, however, is not about the farming sibling; it's about how to treat the non-farming siblings.

When looking at the ownership structure you need to prioritize how you would manage the process. It's recommended that you list them in this order.

1. The retirement of the retiring couple.
2. The farming person and setting them up in a sustainable business.
3. The non farming siblings.

Maintaining family harmony in farm succession requires years of planning so that each member of the family knows and understands the roles, responsibilities and position of the farming sibling or new business partner.

The non-farming sibling will often retain emotional ownership of the farm for many years. Not only because it was their home, but farms are emotional assets; they hold fond memories and are like the family monument. However, it is also important that those siblings allow new management and new ideas to evolve without interference.

10. Your own personality is an important component that influences farm ownership options.

I, (Richard) was taught that everything you learnt in school was important.

However, I believe that the key part of one's life is in that period straight after school up until the age of 25. The reason being you are no longer a dependent and that you must learn to make your own way in life.

So it's how you as an individual deliver yourself to the world.

The values you have at this stage become the ones which will set you up for life. I can see this now that I have been through this process and understand the importance of character development.

- Being tidy and well presented
- Being punctual.
- Being aware of what is around you.
- Caring for others.
- Having integrity

Only you can tell whether you're right or wrong. A conscience is a wonderful thing.(Richard Burdon)

11. Farm structures ideas for succession

Changing the cash or income spread, the capital and the control in the family farm are the three key areas for a farm business to manage through the succession process. It involves planning and some structure changes. It is a process that will take some time and cost, and will need the right attitudes from all parties.

The following is a succession concept that has been implemented by a number of thriving New Zealand family farms. At some stage some of the cash income control and capital have to be passed onto the next generation. This takes time, unless there is a direct sale and purchase or family death.

Stage 1

Planning the exit

- Farming couple start planning their exit from day to day farming.
- The farming couple do a 20 year feasibility on the capital requirements for themselves, the potential equity partner, and the farm.
- Assess where they want the farm to be in 20 years time?
- Aim is to introduce a younger farmer into their business to run the day to day operations and to allow them to have some ownership in the business.
- A review of the scale and size of the operation.
- An assessment of fit and balance is done. What can the business afford and manage?
- Finding the right young couple and being able to develop a long term business together.

Stage 2

Establishing the new structure

- Leasing the livestock to the young couple and allowing them to own some plant, like a four-wheeler and a vehicle.
- Sharing the income, based on the lease agreement.
- Providing clear job descriptions for both parties.
- Provide a clear lease period and then clear direction for the next stage of time that suits both parties, with an option to buy the livestock in five years time.
- Setting up formal structures for governance and financial monitoring.

Stage 3

Next step

- The young couple buy the stock and plant at valuation.
- The older couple retain land and buildings.
- The older couple do the accounts and still have a role on the property.
- Young couple's responsibilities are all livestock, feed management and property maintenance, except buildings.
- Profits are now split 50/50 and both parties are paid a wage which reflects their input. Dividend policies are set by the company.
- Young couple work hard on paying livestock off, so that they can next secure some land and their own house.
- The older couple invest the money from their livestock sale off farm so they are not 100% reliant on farm income.
- The older couple look for the right investment opportunities that are safe and give a return.

Stage 4

Further step

- Older couple sell part of the farm and depending on the scale of the operation either move off farm or retain their homestead block.
- Young couple purchase a part of the farm's land and buildings or a percentage of shares held in the land company.
- Subdivision has become difficult under the RMA so where there are not a large number of titles it would better to have the land in a company structure.
- If we work on the theory that land will double in value every seven years it means the young couple are improving their equity all the time.
- The older couple still get the benefits of ownership and enjoyment from the farm as they watch the young couple develop under their guidance.
- Both parties have to have the right attitude to make this work.

Stage 5

Final step

- Control, capital and income are all to one party, a process that could take 5 to 20 years.
- Ownership transfer is completed and the younger couple start planning their own exit strategy.
- Meanwhile both parties have had a long and rewarding career in agriculture.
- The couple at stage five start looking at stage one again.

As you can see this is just one model. No single model fits all livestock farms but, where parties are willing, opportunities for all can become available.

New Zealand agricultural service companies need to be careful not to lose focus on their own clients (Richard Burdon)

12. What about a straight out equity option?

The main advantages of equity partnerships are that they enable the partners to:

- Pool their capital
- Share the risk
- Leverage specialist skills and/or capital assets
- Achieve high performance efficiencies of scale
- Investors benefit from an opportunity to grow their business and achieve efficiencies of scale with shared capital outlay.
- The managing equity partner benefits from ownership with a reduced level of capital input.
- Retiring farmers benefit from an opportunity to remain involved in the industry.

Issues to be aware of with equity partners

Joint ventures need to be well constructed, and considerable time and effort may be required to set up an equity partnership, particularly at the outset. However, the time is well worth it as getting the structure right at the start is usually an indicator of success in the future. In particular all potential issues should be recognised, addressed and reconciled at the start. Ensure that all issues from each partner are put on the table for discussion to avoid problems later.

A clear exit procedure is one of the key issues to decide at the outset. Good relationships between partners and a common goal for the company are key to success. A shareholders' agreement is recommended to ensure the expected outcomes of the shareholders are identified.

Sound professional advice will help facilitate the process. Expert legal and accounting advice should be obtained.

Finding partners

Equity partnerships normally involve a small group of investors who know each other or are introduced by a common party. Individuals are usually already involved in the rural industry and have a good knowledge of the proposed investment.

Forming an equity partnership is an involved legal and financial process. As many have found, attempting to put an equity partnership together can be complex, time-consuming and costly.

Other issues to be aware of for all equity investments

- **Due diligence:** If you're making a significant investment then you need to make time available to look at the risks, the structures, the types of people you will be investing with and have an understanding of the business.
- **Liquidity:** An investment in property is often not very liquid so it needs to be agreed upon by the shareholders that the investment period is for a minimum period to enable the property to stabilise.
- **The balance sheet:** A strong balance sheet with a high portion of equity is important today in agriculture. There is too much risk in livestock farming for foreign exchange and climate fluctuation to live on a weak balance sheet**.**
- **The communication process:** What is the agreed communication process? What is the process for meetings that deal with issues, and the roles of shareholders directors and managers? These all need to be clarified. Reporting standards need to be developed and they need to be consistent and well presented.
- **Goals:** Where do the shareholders goals sit with the investment, and how often should they be reviewed? How is this communicated around the shareholders?
- **Dividend policies:** What do the directors recommend and what do the shareholders want? This all fits in around the communication strategy.
- **Insurance risk** Life cover is a good way of managing some risk in a business when the business has debt and becomes very reliant on the manager to deliver. When people die or get sick businesses change.

Seasonal finance is expensive. Why can you borrow money for a tractor at 4.8% fertiliser at 11% and livestock at 12%?(Richard Burdon)

13. Trends that will affect how you make your farm structure and ownership model

Farms are getting bigger and family farms need to continually reassess their ownership model.

Many livestock farmers feel that they do not get control at an early enough stage and it is a hard cycle to break.

Availability of capital appears to be a key underlying factor

- The high capital value of land causes a barrier to entry (young people)
- Family farm succession may be harder to achieve. *Our own property has increased in rateable value valuation by $800,000 per year for the last 15 years, that rate is a compounding annual capital rate of (CACAR) of 13.85% per annum.*
- *We are still being paid the same for our merino wool as we received in the 1990s. In real terms we see this merino model as being no longer sustainable for at least 75% of merino growers.*
- The farm expense price index rose by 5.5 percent over the year ending 31 March 2008. This is a high risk area for farmers these days as cost seems to be the major killer, along with interest, on getting a good business result.
- The gap is widening between dairy, sheep and beef farm income, or business results (BR). For many sheep and beef farmers if land values go down, their businesses will be in trouble.
- Low returns and more restricted access to bank finance is limiting
- Equity is limiting the ability to pursue development and other investment options to grow the business.
- Negative or low cash returns provide little revenue for an investor; therefore they are relying on “safe investment” and capital gains.

The need for highly multi skilled advisors is increasing:

- More farm businesses will involve consultants or supervisors and there will be a strong requirement for many businesses to have administration roles.
- There may be stretched availability of those who are perhaps in a position to provide this advice.

Poor governance.

- Lack of ability of governance skills, based on lack of understanding of the uniqueness of the agri-sector.
- A mentality within the agri-sector that professional governance advice needs to be obtained on the cheap.

Looking outside the square.

- To become attractive for an investment opportunity the farm often needs something else to attract the investor. It needs to be able to access some exciting farm development and tourism opportunities

Developing good environmental farm plans for most is a lifetime's dream and work, and should not be a rule in a district plan (Richard Burdon)

Ownership and management structure options for livestock farmers: what works best for your business?

Structure Type	Cash	Plant and Machinery	Livestock	Shares	Land	Human Resources	Off farm Income
Owner operator							
Equity partner (Passive)							
Equity partner (Active)							
50/50 Partner							
Lessor							
Owner and Shareholder shepherd							
Own Stock not land							
Own Plant and Stock lease land							
Own Land No Stock							

Look at all the options, the amount of capital available and then develop the plan around what is most economically viable and works for all parties. Work out what boxes work for you and then develop a plan around them. Remember to do the maths.

No one plans to fail… however we shouldn't fail to plan.

14. Different structures to think about.

14.1. Trusts

14.1.1. Fixed family trusts which often excluded a spouse as a discretionary beneficiary and are extremely restrictive in terms of what you can do in allocating capital and income. These types of trusts were a very big limiting factor on what you could do from a structuring perspective for any given client, in other words you inherited what you started with.

14.1.2. Trusts will continue to be utilised into the future and will play a role mostly within family ownership structures. The capital compromises that are required within families to have any chance of successive generations taking on family farms will require ownership to be transferred via trust entities. Parents, for want of a better word, are very anxious to ensure that family capital is protected from the provisions of the Relationship Property Act to the extent that this can be achieved.

14.1.3. The utilisation of trusts as a shareholder in land ownership companies will continue and perhaps strengthen.

14.1.4. There has always been a strong mantra within the agri-sector of paying out your non farmers first. This mantra will come under pressure and in the future we will see more “Todd” type family arrangements where there is an ongoing family ownership within a farm and its operating entities with no voting input, but which does provide some sort of income stream for successive non-farmer generations.

14.2. Companies

14.2.1. Companies have increasingly become the entities of choice and most of the structures that we have been involved with utilise a company in some format.

14.2.2. Over the last few years there has been a pronounced trend to a land ownership company, the shares of which are held often through the use of a family trust, and with lesser amount of individual shareholding, and then a separate operational entity carrying out the farming and commercial activities often in which the spouse is involved. There have also been a number of companies which effectively the land and operational ownership is held through. Again, with the split of ownership in shares reflective of the balances that are trying to be achieved within a family, ie spousal ownership, ownership kept in reserve for retiring parents, trusts etc.

14.2.3. LAQCs (Limited Assets Qualifying Company) have been utilised very effectively in the agri-sector often when outside investors are brought into a development programme, particularly common in the dairy sector. This has allowed capital to be introduced from, for the want of a better term, “Queen Street farmers”, allowing them to minimise their tax position but giving the upside of significant capital gain arising from the completion of development programmes. This will come under pressure as capital values flatten out or perhaps decrease. The limited partnership regime that has recently been adopted, but still involves an element of companies being utilised, is likely to become the preferred structure of choice. It would be fair to say at the moment that very few law firms and accountants have an understanding of limited partnerships and how they can be utilised.

14.2.4. Companies will continue to be used in most circumstances because of the flexibility they offer in terms of transfer of ownership stakes and the ready made governance structure that companies provide. People understand the concept of a board of directors.

14.3. Partnerships

14.3.1. The traditional path of ownership in a family farming operation has been the son buying into the stock and plant and then somewhere around the age of 40-50 he is then ready to move into farm ownership once he has “earned the family’s trust”. This type of archaic thinking that has destroyed many a family and the capital wealth of those families and is not where we want to be heading.

14.3.2. Partnerships will still be utilised in simple farming family arrangements and often they are utilised very effectively for relatively small operations because they are cost effective.

14.3.3. With greater concerns around the provisions of the Relationship Property Act, and the sheer amount of capital involved, partnerships will be utilised in at least the family situation less often.

14.3.4. We do from time to time see a number of suggestions from accountants about the utilisation of trading trust partnerships. Our experience is that they are bit like “swap loan facilities”. Even the most commercially sophisticated of clients generally struggle to understand them.

14.3.5. In the corporate sector partnerships continue to be utilised where the LAQC structure for tax reasons is not appropriate, but these are usually quite complex joint venture type arrangements.

14.4. Limited Partnerships

14.4.1. A limited partnership registered under the Limited Partnership Act 2008 (LPA 2008) shares the same fundamental legal features as an ordinary limited liability company. That is, the limited partnership is created upon registration and has a legal status that is separate from its owners (ie its partners).

14.4.2. Each limited partnership must have a written partnership agreement which governs the affairs of the limited partnership. The agreement must comply with certain minimum content requirements of the LPA 2008. A limited partnership may have an unlimited legal life. Succession issues are not a problem as the partnership does not cease on entry or exit of a partner rather it only ceases when it is removed from the register. The partnership agreement establishes the exit valuation method in prescriptive form.

14.4.3. There will be one general partner who is responsible for the day-to-day management of the partnership. A new company will act as the general partner, the shares in which are owned by the limited partners in proportion to their interest in the limited partnership. The company constitution will address governance issues including appointment of a board that will have two independent directors.

14.4.4. Only limited partners will be able to contribute capital while the general partner has unlimited liability for partnership debts. The limited partners are only liable for limited partnership debts to the extent of their capital contribution as long as they do not take part in managing the partnership. This contribution and the number of investors will be dependant on the investment option subscribed too.

14.4.5. The limited partnerships are treated as “flow through” vehicles for income tax purposes. Put simply, the net result for the year is apportioned to the partners based on their ownership percentage with the resulting tax position being dependent on the partners’ individual position. There is no non deductibility of interest issues where funds are borrowed by the partners to contribute as limited partners as they are deemed to own business assets.

14.4.6. We think that limited partnerships have considerable potential to be used as a succession vehicle even in family ownership situations but as understanding of the utilisation increases are likely to become the vehicle of choice in multi investor situations. A number of farm of agri-corporate clients have restructured into limited partnerships because of the flexibility they provide in terms of both attracting capital, the taxation advantages that are available investors and again the split between operational matters and ownership that this form of structuring enhances.

If an English sheep farmer gets paid 75 pounds for an 18 kg lamb, then why don't New Zealand farmers sell all their lambs to English processors? Surely it does not cost $160 to ship to England. (Richard Burdon)

15. Conclusions on farm structures and the future of the family farm

15.1. The sheer capital requirements the agri-sector will be required to fund increased productivity and therefore yield, will mean that increasingly the family farm will come under pressure.

15.2. The only family farms that will survive into any reasonable future will be those that handle their capital demands within the family in an innovative and commercially pragmatic manner. This will require a new form of thinking within families and their advisers.

15.3. There could be a significant number of family owned farms that may not be structured to step up to the skill set required to manage increased intensification. These situations may also not be able to attract capital in a difficult environment. It will require a mind set shift to a commercial governance culture. It will require a focus on wise use of capital sometimes at the expense of the emotional attachment to a farm.

15.4. There will always be a role for family farming operations, but that will most likely increasingly evolve to families which are in a strong capital position and have the capability to match that from a governance perspective, and to smaller family farms with less operational demand and little debt.

15.5. The sector will inevitably see continued growth of multi investor farm ownership, the farm and productive ownership with specialist niches being created by some of these entities. This will mean a pronounced change in the management and governance of these joint ventures with what might be perceived at the present point as quite complex ownership arrangements.

15.6. Joint ventures and commercial co-operation will increase markedly.

Any business plans based on succession plans will be based on the concept of fairness rather than equality (Richard Burdon).

16. What to look out for: different scenarios that may affect a farming family during its lifecycle

Change in the farming practice.

- Concern over cash flow, profit and the business of farming.
- Income distribution and dividend policy.
- Capital developments and return.
- Different ideas over management.
- Discomfort over debt.

External pressures

- Drought and poor prices.
- Floods and fire.
- Changes in government and council policies.

Generational conflict.

- How to include a young family.
- No-one wants to manage the family farm but it's too good to sell.
- Parents ready to retire and move on or remain active on farm.
- How will ownership of different assets be handled?
- How non-family employees are managed vs family.
- Someone dies or becomes dependent.
- What insurances and superannuation programmes are in place?
- How do you treat all children fairly?

If you haven't done the maths then be prepared to burn the cash. Having spent some time with a banker over that last year I learnt to understand the time value of money and how a banker sees the world. (Richard Burdon)

17. The structure is '*right*', but do you have the '*right*' to farm?

17.1. Legislation and regulation

You may have the right structure but have you the stomach to put up with today's legislation and regulation. We all know that land ownership comes with a "bundle of rights". How that bundle is divided between various stakeholders depends of issues such as legislation - at central and local level - regulation, lease conditions, licence conditions and other contracts. Legislation and regulation can erode the "bundle of rights". A full assessment of such rights is an essential part of the evaluation process.

Legislation and regulation can have unexpected and far reaching effects and, equally, they can and frequently do have interesting and creative behavioural effects on farm property.

In particular there is a raft of legislation and regulation aimed at conservation, animal health and environmental and community sustainability. This legislation and regulation seeks to provide protective mechanisms by establishing conditions and standards, but also by limiting activity by such means as water rights or subdivision density, the application of zoning restrictions, landscape and conservation values or even access points off state highways. The limiting of such activities does have the potential to create localised monopolies. For example a farmer may be seeking consent to establish an on farm tourism venture and objections are received from commercial interests.

Where it becomes important to existing farming operations and their logical or natural development are the issues surrounding water take permits for irrigation or the consenting of farm tracks to allow new areas of land to be further developed. In this latter example a farm road across an area of significant landscape value may not achieve consent yet the farm next door may be able to gain access to the same area by a different route and thus place a different value upon the land targeted for development.

When setting up farm ownership structures, all property reports need to consider the effect of current and proposed legislation on the ability to manage that property under its current arrangement, and any new or proposed district and regional plan and legislative changes.

The effects on existing rights that come up for renewal need to be factored in to land values. An assessment should be made for any risk attached to a renewal that may result in modification to conditions such that the value of the right is diminished, enhanced or rendered uneconomic or unusable, or indeed renewal is simply not possible.

17.2. Resource Management Act 1991

The purpose of the RMA is to promote the sustainable management of natural and physical resources. The definition of sustainable as noted in the Act means "managing the use, development, and protection of natural and physical resources in such a way, or at a rate, which enables people and communities to provide for their social, economic, and cultural well being and for their health and safety while-

(a) sustaining the potential of natural and physical resources (excluding minerals) to meet the reasonably foreseeable needs of future generations; and
(b) Safe guarding the life –supporting capacity of air, water, soil, and ecosystems; and
(c) Avoiding, remedying, or mitigating any adverse effects of activities on the environment".

However, the RMA can, for all its admittedly good points and intentions, be used to dissuade commercial opposition, ration services, create opportunities for lobby groups, discourage some development altogether, suppress other development or apply conditions and limitations such that envisaged development is rendered economically untenable.

Farmers need to up-skill in understanding the nuances contained within the RMA and up- skill to engage with policy people, planners and regulators in a meaningful way.

Observations (Richard Burdon)

Leadership vision and energy is hard to maintain in an industry where cost of capital and stock is high, the margins on the livestock is small. But we know staying at home will not resolve this issue.

Lamb, the most expensive red meat in most supermarkets, has the biggest potential to be grown out into larger better performing cuts and is still sent to many of our overseas markets in unprocessed form. As New Zealand farmers we pay a levy to promote lamb meanwhile while our processors are fighting, slashing not hedging and burning our hopes of prosperity.

As farmers we need to face up and manage the 'smoke and mirrors'. We are often told by well educated people what we want to hear, when it should be what we need to hear. Farmers need to be realistic, challenge, and continue to develop smart business ethics.

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