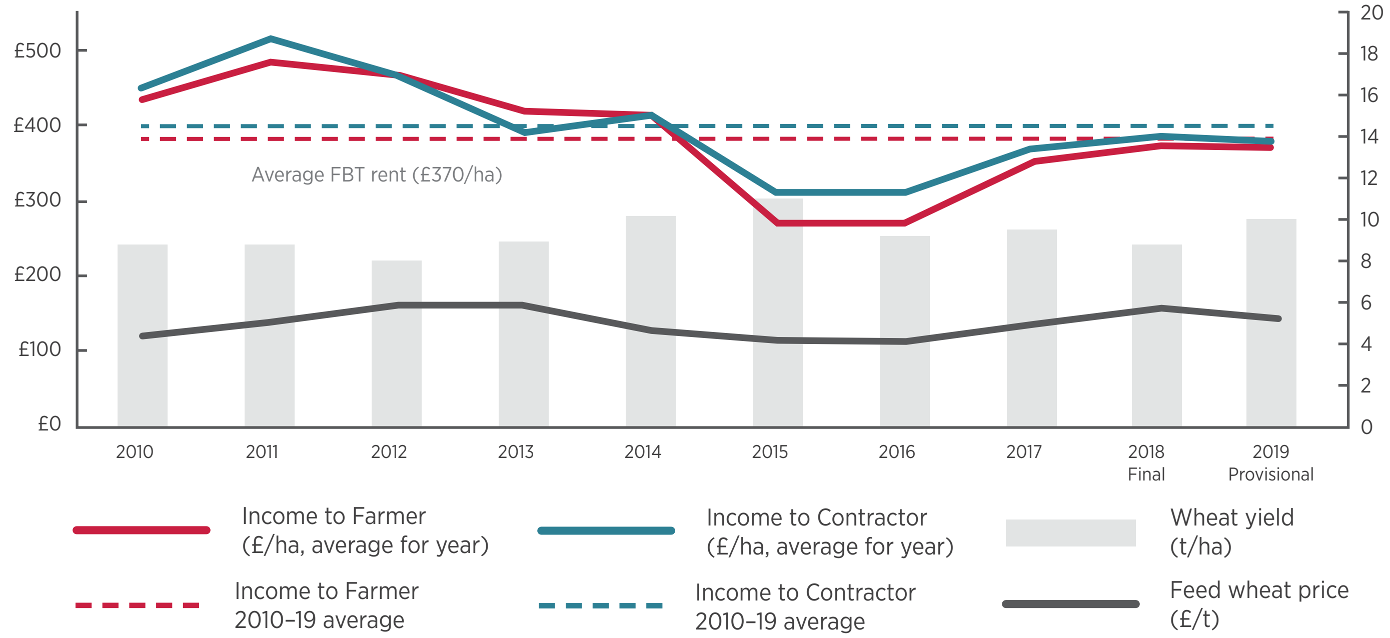
STRUTT & PARKER
BNP PARIBAS GROUP

English Contract Farming Agreement Survey

Harvest 2019 (provisional results) and Harvest 2018 (final results) | Summer 2020



Market overview

The 2019 year produced some good yields and better crops compared with the drought-hit harvest of 2018. However, this large wheat crop put prices under pressure and so limited the increase in crop receipts. Slightly higher variable and fixed costs were partially offset by higher than expected Basic Payments. Overall, net margins were up by just under 3% on the previous year.

Average income to the contractor was marginally down on 2018 levels, but above the five-year average. Income to the farmer rose, as farmer's retention and share of the divisible surplus increased.

Continued overleaf.

At a glance[1]

Receipts and costs

Receipts* are expected to be higher in 2019 than in 2018, due to higher yields.

Variable costs rose to £439/ha, the highest in four years.

* Receipts from crop sales, Basic Payment Scheme and agri-environment scheme payments (if the land is in the scheme).

Income

Income to the farmer is expected to be £392/ha in 2019 (average for year). There is a clear increase in the past four years – to both parties.

Income to the contractor is expected to be £395/ha, which is about the same as last year and above the five-year average.

Long-term performance

Contract Farming Agreements (CFAs) continue to give farmers an income that is comparable with a 3-5 year Farm Business Tenancy (of around £370/ha (£150/ac) rent).

Their advantage is that the farmer has lower power, machinery and labour costs than a typical cereal farm (of £420-440/ha[2]), and they maintain the tax advantages and flexibility of being a trading business.

Over five years from 2013, CFAs have produced profits for farmers (five-year average of £334/ha) that are above those of the middle 50% of farming businesses (£268/ha from agriculture, Basic Payments and agri-environment).

[1] NB All figures are averages for CFAs that are arable only agreements (i.e., exclude agreements with root crops). For agreements with root crops, see the section from page 6 onwards.
[2] Please contact our farming team if you would like to discuss a review of your labour and machinery costs..

Market overview

Continued from page 1

Renegotiations, new agreements and tenders

Agreements that were reviewed during the year generally saw a shift in the balance of risk from the contractor back to the farmer through a higher basic contractor's charge to reflect rising labour and machinery costs.

CFAs and changes in support

Basic Payments are due to reduce from 2021 and this will affect the income to the farmer in CFAs, as many keep the Basic Payment (BPS) as part of the farmer's retention. Although the government has said that support for farming will remain at current levels, the profits farmers make from it will fall, as BPS is about 80% profit while agri-environment schemes are 10-20% profit. Agreements will need adjusting to reflect these changes.

The design of ELMS will evolve from 2022 onwards, so the best approach is to be as flexible as possible about what land is cropped and what is used for other purposes. Agri-environment agreements are likely to cover larger areas of land and have greater impact on crop rotations. CFAs that allow cropped and environmental areas to 'flex' will be needed – taking out unprofitable areas and producing 'environmental goods' where valuable.

CFAs may develop to include different payment rates for each crop or environmental option for the basic contractor's charge and farmer's retention. This will be more complicated to administer, but the fairest way of dealing with the coming changes.

A well-structured CFA remains a very good vehicle to manage a farm as both parties can be incentivised, their skills utilised and economies of scale realised. Ultimately, farmers must be seen to take some of the risk from growing crops and contractors need fairly rewarding for the retained running costs of labour and machinery and the management skills they bring.

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 2019 include the detailed financial results of 76 CFAs covering 20,200 hectares (49,800 acres), and our database includes the annual financial performance of almost 900 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 2019 provisional results are based on estimates of crop yields and financial performance as at 31 May 2020. We will produce final results based on actual yields, income and costs in late 2020.

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 20 agreements for which we have data from 2013 onwards, 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. 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 6.

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 2019 includes actual yields from 137 farms covering 110,600 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. The farmer 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, expertise and ability to use new technology. 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.

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 the 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 agri-environment scheme payments (if the land is in the scheme). 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.

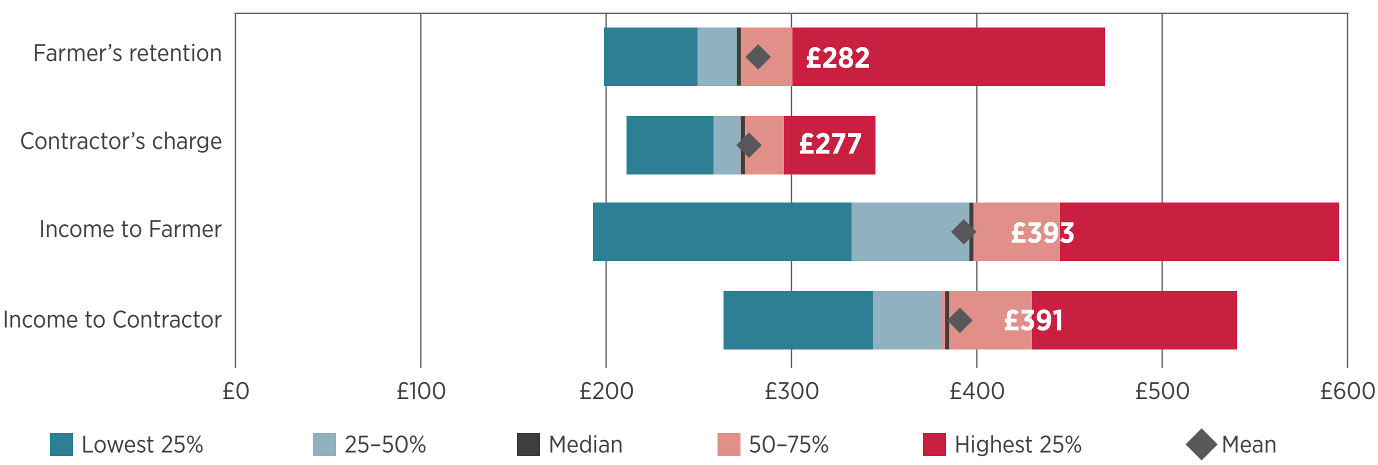
Results for arable agreements (excluding agreements with root crops)

- Slightly higher receipts expected (from crop sales, BPS and agri-environment payments), due to higher yields.
- Higher income expected for the farmer. Contractors likely to receive similar income to 2018. Both well above the five-year averages.
- Income to middle 50% of farmers is £331 to £444/ha. Income to middle 50% of contractors is £343 to £430/ha.

Figure 1 **Receipts, costs and income to farmer and contractor from arable agreements**

Annual averages (£/ha unless otherwise stated)[3]	2010	2011	2012	2013	2014	2015	2016	2017	2018 Final	2019 Provisional
Number of CFAs	27	26	51	38	44	37	49	59	66	60
Area (ha)	4,469	4,123	9,470	6,593	6,737	6,294	8,973	12,423	13,292	12,093
Receipts	£1,300	£1,441	£1,483	£1,330	£1,395	£1,104	£1,101	£1,232	£1,261	£1,332
Variable costs	£350	£382	£486	£478	£493	£459	£416	£398	£395	£439
Fixed costs	£94	£88	£96	£93	£99	£94	£104	£115	£97	£112
Contractor's charge	£230	£243	£242	£261	£266	£275	£265	£269	£275	£276
Net margin	£627	£727	£658	£498	£537	£276	£316	£448	£493	£506
Farmer's retention	£234	£235	£258	£278	£278	£280	£247	£283	£270	£285
Divisible surplus	£393	£512	£401	£232	£259	-£4	£68	£166	£223	£220
% of agreements making a negative divisible surplus	0	0	0	8	14	51	39	8	5	17
First split to farmer (%)[4]	30	33	33	37	42	48	42	44	44	44
First split to contractor (%)	70	67	67	63	58	52	58	56	56	56
Income to farmer	£435	£484	£466	£405	£417	£271	£273	£361	£374	£392
Income to contractor	£453	£517	£464	£381	£414	£309	£311	£362	£398	£395
Income to farmer (%)	49	49	50	51	45	42	46	50	45	49
Income to contractor (%)	51	51	50	49	55	58	54	50	55	51

Figure 2 **Range of returns to the farmer and contractor from arable agreements (2019 provisional) (£/ha)[5]**



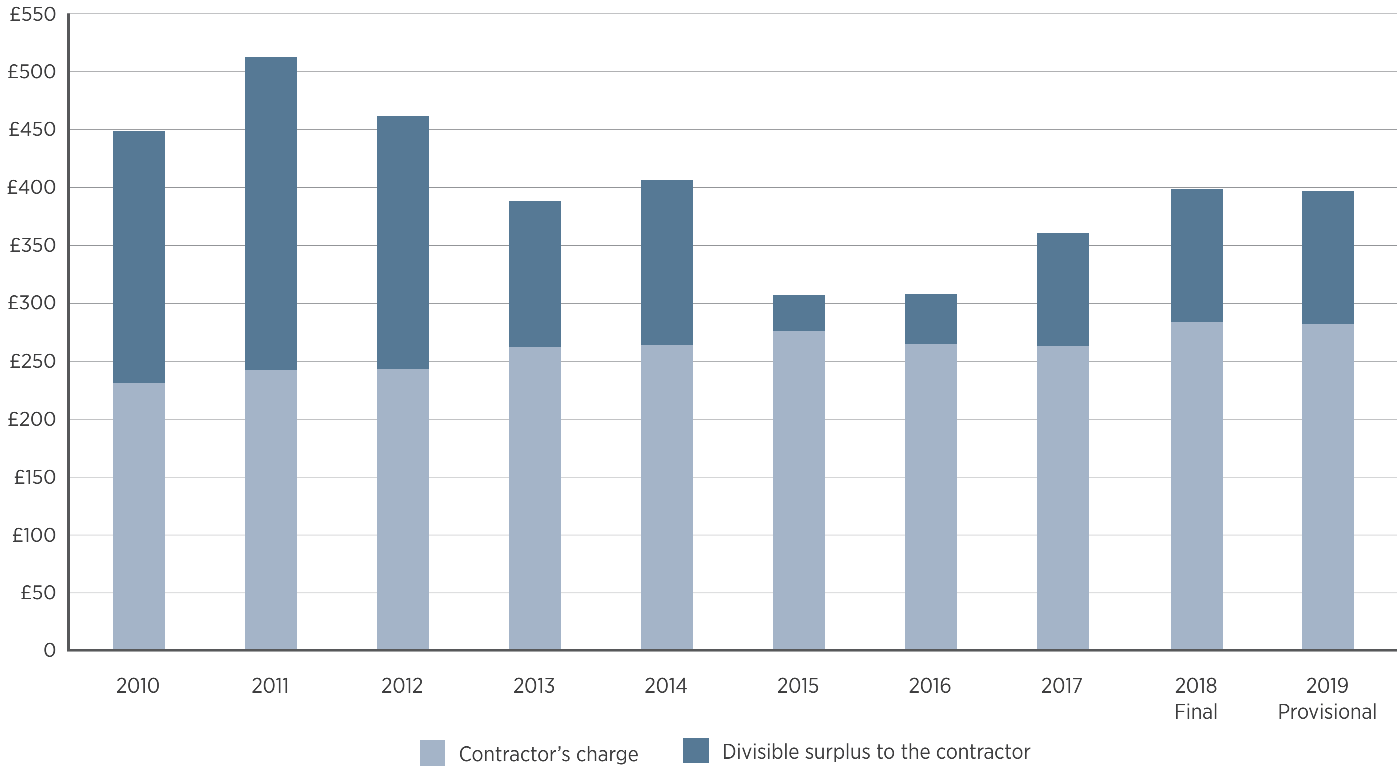
[3] The figures shown in the tables are the average for all of the CFAs for each measure, such as variable costs. This method produces figures that are the most reflective of reality but they do not 'sum' precisely (i.e., receipts less costs does not precisely equal net margin), which would involve 'summing'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

[4] 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.

[5] 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 (2010–2019 provisional) (£/ha)[6]**

Figure 4 **Average of contractor's charge and divisible surplus to the contractor from arable agreements (2010–2019 provisional) (£/ha)**



[6] In 2015, the divisible surplus is negative for farmers but positive for contractors as 19 of the 37 CFAs had negative divisible surpluses, which were allocated entirely to the farmer, but 18 had positive divisible surpluses, which were allocated between the farmer and contractor.

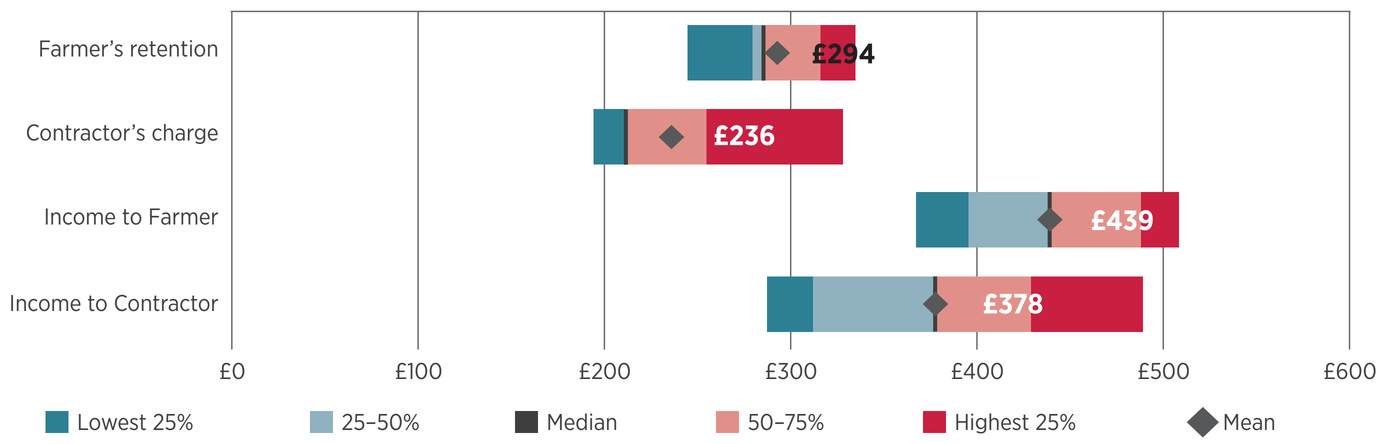
Results for agreements including root crops

- Similar receipts expected compared with 2018 and around the five-year average.
- Contractor's charge slightly lower and still below five-year average.
- Higher income for 2019 expected to both farmer and contractor, compared with 2018.
- Income to middle 50% of farmers is £395 to £488/ha. Income to middle 50% of contractors is £313 to £429/ha.

Figure 5 **Receipts, costs and income to farmer and contractor from agreements including roots**

Annual averages (£/ha unless otherwise stated)[7]	2015	2016	2017	2018 Final	2019 Provisional
Number of CFAs	10	14	13	19	15
Area (ha)	4,214	6,838	6,095	7,880	8,022
Receipts	£1,293	£1,218	£1,343	£1,368	£1,361
Variable costs	£373	£363	£393	£404	£382
Fixed costs[8]	£182	£153	£140	£193	£162
Contractor's charge	£245	£268	£245	£249	£230
Net margin	£492	£433	£562	£522	£587
Farmer's retention	£363	£365	£261	£286	£281
Divisible surplus	£129	£68	£301	£237	£302
% of agreements making a negative divisible surplus	20	36	0	11	0
First split to farmer (%)[9]	31	36	42	43	45
First split to contractor (%)	69	64	58	57	55
Income to farmer	£435	£387	£408	£397	£440
Income to contractor	£331	£316	£400	£375	£381
Income to farmer (%)	56	54	50	51	54
Income to contractor (%)	44	46	50	49	46

Figure 6 **Range of returns to the farmer and contractor from agreements including roots (2019 provisional)[10]**



[7] 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.

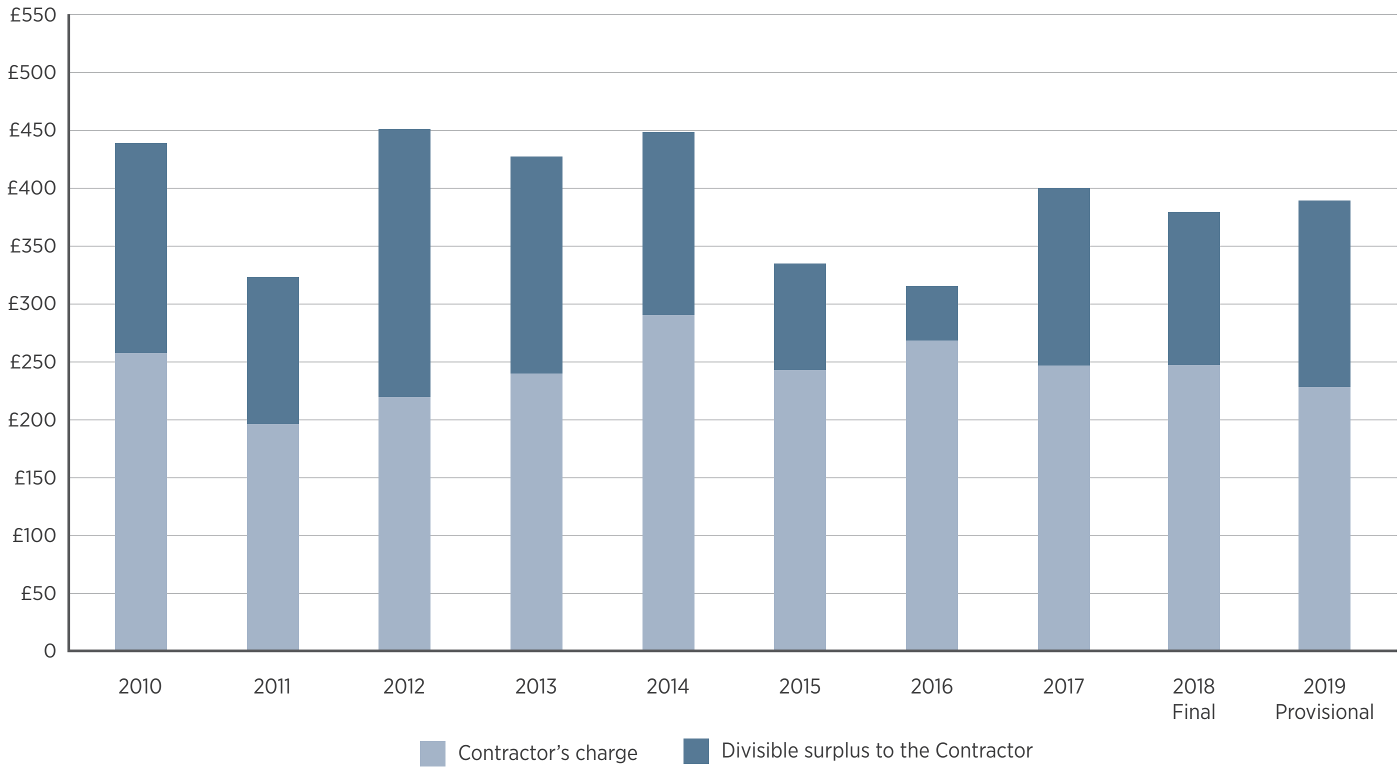
[8] Fixed costs for these agreements are higher than for agreements without roots as they include specialist contracting operations.

[9] 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.

[10] 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 (2010–2019 provisional) (£/ha)**

Figure 8 **Average of contractor's charge and divisible surplus to the contractor from agreements including roots (2010 – 2019 provisional) (£/ha)**



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