

How do I calculate a fair leasing rate for Agricultural Land?

Agribusiness Hot Topics – LAND LEASING

Question- How do I calculate a fair leasing rate for Agricultural Land?

Leasing (other than Agistment) of privately owned land in Australia is quite a common practise. Particularly for new start young farmers wanting to accumulate capital and experience to purchase and manage their own farming business. Leasing agreements in Australia have in the past historically been pretty informal arrangements between the landholder (lessor) and the person wanting to lease the farm (lessee).

We at farm Agribusiness Solutions have been asked on many occasions how to calculate a fair lease rate or rental. Now, this is dependent on many variables but particularly the type of property and its location and income earning potential. We have tried here to cover the most common forms of leasing arrangements entered into within Australia today. We add that what we have outlined is a guide only. All intended agreements should be negotiated on a *win- win* basis and reviewed by a solicitor and a formal agreement signed by both parties. We are happy to help.

What is covered?

We have tried to give a broad overview of the following:

- 1. Legal implications**
- 2. How to calculate a fair lease price for the most common lease agreements, Grazing and / or Farming:**
 - Percentage of market value method;
 - Farming country: and
 - Livestock production
 - The budgeting method.
- 3. Key Factors to consider in a lease agreement**

Legal implications and protection of parties

The Agreed terms and conditions between parties will vary considerably. It is therefore highly recommended that you have a Solicitor prepare a legal agreement which covers all issues agreed to between both parties.

The Australian Tenancies Act 1990 applies to agricultural tenancies of land greater than 1 hectare in area and where the land is used wholly for or mostly for agricultural purposes. The Agricultural Tenancies Act considers a number of different tenancy types depending on the lease term. We recommend that you refer to:

- Agricultural tenancies Act 1990; and
- Agricultural Tenancies Regulation 2006

The Agricultural Tenancies Act is not difficult to understand and we recommend that if you are considering a lease it would be worth while reading before entering into any sort of agreement. The Act amongst other issues covers the rights of owners (lessor) and tenants (lessee). Most importantly any agreement should include an exit clause for both parties.

How to calculate a fair lease fee

The most common question we are asked is how to calculate a fair lease fee.

The market for leased land in Australia operates on the same principle as buying or selling real estate: Supply and Demand. Most commonly, leasing rates are based on a percentage of the usable land value. Consequently as land values rise so do leasing values. The reverse applies if the market value for land falls. Lease values for dry land properties generally range between 5% and 9% of usable land value.

We recommend that before entering into a lease based on the *percentage of land values* you check the rate against an alternative method outlined below to ensure that land values in the district reflect the earning capacity of the land.

Percentage of market valuation method

Dry land Farming Operations

Under the percentage of market value method, If, for example, land is valued at \$1500 per hectare and the agreed rental value is 5% (lower end valuation) of the land value, then a lease fee equivalent to \$75 per hectare would be applied and required to be paid by the tenant (lessee).

How do you arrive at realistic land market value? This can be agreed to between the parties and is generally based on recent land sales within the area of properties that are similar in land characteristics to the land to be leased. A good guide can generally be got by obtaining an Estimated Market Valuation /Appraisal (EMV) from a local Real Estate Agent.

Irrigated Farming

For irrigated land a rate of 10% of the value of the developed Country is generally the most common. As with all lease agreements the rate will ultimately be determined through negotiation.

Irrigation land attracts a higher rate as there is more certainty of returns on investment for both parties. In some cases, such as for high returning crops such as land for Cotton, the demand might be greater which will

result in leasing rates asked being higher than 10% of land value.

Consideration here is needed to be given to the reliability of water allocation. Properties with a more reliable water supply will obviously demand a higher lease percentage. So it is important that any percentage of land value agreed should reflect the reliability of the water supply.

Livestock Production

Leasing land for livestock production is not the same as agistment which is generally short term in nature. The responsibilities of the Lessor and Lessee and terms and conditions of the agreement can be considerably different in each circumstance.

Leasing land for grazing is based on the same principles as those for leasing land for dry land farming. The fair rental value will generally fall between 5% and 9% of the Estimated Market Land Value. A good guide can generally be got by obtaining an Estimated Land Market Valuation /Appraisal (EMV) from a local Real Estate Agent. Again we recommend that a formal agreement between both parties should be drawn up by a Solicitor and signed by both parties.

The Budgeting Method

The budgeting method works on the principle that a fair rental should be based on a percentage of the potential return for the farm enterprise. For cropping generally 25% of the budgeted Gross Margin income from cropping and a long term agistment rate for livestock.

The two methods, percentage of average capital (land) value and the Budget method can be compared as demonstrated in the example following:

For Example

Total farm area 2000 ha

Wheat sown 200 ha

Summer crops 400 ha

Sheep 500 hd

Cattle 150 hd

Assume that the average capital of the property was \$2,000,000. Assume that 25% of this capital is machinery and buildings not part of the lease. This reduces the value of the land for lease to \$1,500,000. Using the capital value method at 5% of capital value, the lease would be around **\$75,000** p ann, or **\$37.5** per total ha. At 9% of capital value the lease would be \$135,000 p ann or \$67.5 per total ha.

Alternatively using the budgeting approach:

Crops at 25% of Gross Margin Income:

For example

Wheat \$ 200 per ha (GM) @ 25% x 200ha = \$10,000

Summer crops @ \$200 per ha (GM) @ 25% x 400 ha = \$20,000

Sheep at \$0.35 per head per week

500 hd @ \$0.35 per hd per week (52 wks) = \$ 9,100

Cattle at \$3.00 per head per week

150 hd @ \$3.00 per hd per week (52 wks) = \$ 23,400

Total lease payable **\$ 62,100**

OR

Lease payable per ha **\$ 31.05**

Note

These are examples only and gross margins will vary between properties and regions.

The information contained in this article is based on the currency of available information, the authors knowledge and understanding at the time of writing.

References:

Agricultural Tenancy Act 1990

Agricultural Tenancy regulation 2006

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