As profits come under increasing pressure in the arable sector, now could be a very good time to consider a contract farming agreement

By Robert Harris

Talk to any business adviser about contract farming agreements and there is one thing they all agree on – more farmers should be using them.

Introduced 20 years ago they have certainly stood the test of time. They may have been modified to cope with increasing volatility, both of input costs and cereal prices, and the introduction of the single farm payment and environmental payments, but the concept remains the same.

A farmer appoints a contractor to grow his crops for him, while retaining his working farmer status. The farmer provides the land and perhaps some buildings as well as the working capital for all crop inputs.

In return, he receives a first or prior charge – a first call on profits, as well as a share of the divisible surplus, which is the profit remaining after deducting the contract charge and other overheads.

As well as his charge, paid regardless of profit, the contractor also receives a share of the divisible surplus.

This arrangement has proved so successful that well over half of farmers in the arable heartland of the east are reckoned to be involved in a CFA

Several areas can cause problems within CFAs and need to be addressed, says Philip Wynn of Wynn Business Partnerships.

Managing risk in volatile markets demands a robust agreement that's fair to both parties, he explains. "Increasingly, the question is how you deal with windfall profits. You don't want to fix an agreement at the low end of the margin scale, but on the other hand you can't be unrealistic either.

"You want an agreement that produces an equitable split whether wheat is worth £105/ or £150/t. It should not allow the contractor to walk away with very high returns when prices spike."

The best way is to introduce two splits in the divisible surplus. "On a 4-500 acre farm you might be looking at £20-30,000 with the SFP payment included," says Mr Wynn.

The initial split would be allocated 80:20 or 70:30 in favour of the contractor, depending on the level of the prior charge and the contract fee. Thereafter, any additional profit should be split 50:50 or slightly in favour of the landowner.

Grain storage can be another key area that prompts people to enter a CFA. Plenty of storage is no longer up to scratch, and a CFA might be a good way of getting access to decent facilities.

However, few contractors are likely to be able to segregate grain by farm, particularly if several different varieties are grown for particular markets.

“The best way is to pool drying charges and grain sales,” says Philip Wynn. “This not only gets over the segregation problem, it also helps remove stress at harvest – everyone wants to be first on the contractor’s list, but only one person can be.”

Another advantage of CFAs is that they can introduce non-combinable crops like beet and potatoes into the farmer’s rotation, introducing rotational and weed control benefits.

The simplest way to deal with this is to exclude high-value crops like potatoes from the CFA, and take out a one-year FBT or cropping license instead.

“For a crop like sugar beet, where the contractor owns the quota, the best method is for the contractor to pay the farmer the equivalent of what he would have made, based on the crops on the remaining area.

“Both gain – the contractor will probably get better yields from virgin land, the introduction of another crop may take out second wheat’s, and it might provide an opportunity to control troublesome weeds.”

Compliance must be included in any agreement, to safeguard the SFP, including crop management plans, fertiliser management plans and N max. “The contractor should be responsible for this, and it should be documented for auditing purposes.”

An annual figure should also be included for property costs, to allow for wear and tear on the farmer’s roads and buildings, such as grain stores. “For the sake of £1000 or so a year, it saves hassle if anything goes wrong. Other overhead costs that are easily missed should also be included, like water charges and crop insurance.”

Philip Wynn always advises his clients to include the SFP. “Why take it out? It’s a valid part of farm income, and should be treated as such. As far as the taxman is concerned, the farmer needs to be taking a risk so why fudge it?”

However, it is simpler to leave out ELS and HLS payments. “It’s far easier for the money to go straight to the farmer. He can then pay the contractor separately if he wants any work done.”

Clauses to cover a change in the farmed area should also be included. “A significant reduction could leave the contractor with an area that prejudices his overheads, especially if he geared up specifically for the contract. He may want an opportunity to give notice if this happens.”

One final area that can cause problems is the farm shoot. “The contractor has a lot of acres to cover, and machinery often runs around the clock. You’d be surprised how often gamekeepers can get upset.

“It’s a good example of why it pays to think through as many parameters as you can at the outset. That way you are far more certain of a favourable outcome all round,” says Philip Wynn.