

INVEST IN DAIRY CATTLE TO EARN A PASSIVE INCOME

Introduction

There are few professional business people who are aware of the benefits of investing in dairy cattle, as an opportunity to earn significant passive income. This type of investment has been around for over 20 years in the dairy farming community, and it seems to be becoming increasingly attractive to both dairy farmers and investors (inc. city based business people) alike.

Historically, the leasing of animals took place amongst Dairymen themselves, and to a lesser extent others involved in the industry (i.e. Consultants and Semen agents et al.) Latterly however it has become apparent to non agricultural business people that the purchase of dairy animals is a convenient, tax efficient and lucrative investment which entails no other effort than that of ownership.

The return on investments differs vastly and depends on where the farmer leasing in the cattle is situated, the size of the farming enterprise, how well established he is, and his reasons for wanting to lease in cows or pregnant heifers.

Read on to find out how a Lease contract works; principles that apply; options on how to structure the transaction; what return on investment to expect and an example of a lease agreement.

The reasons an INVESTOR would lease OUT dairy cattle

A Dairy Farmer (also an INVESTOR) leasing out some dairy cattle would typically be financially comfortable and secure, but over-stocked and unable to buy another suitable and proximate dairy farm (availability a big factor). Other farmers in a similar situation would prefer to sell their surplus stock and invest outside of Agriculture.

Non Farmer INVESTORS have the opportunity of purchasing cattle (from the above Dairy Farmers) to Lease OUT to Dairymen who have the need for numbers, but not the capital to purchase the stock

Reasons why a Dairy Farmer would lease IN dairy cattle

Dairy farmers leasing in dairy cattle could either be well established but need to quickly grow numbers to benefit from the economies of scale, or where a beginner farmer needs to apply scarce capital to infrastructural development, with the leased cows providing the income and some capital growth (in calves born), whilst at the same time bearing the risk of any mortalities. By doing this, available capital is used for plant and other fixed improvements. The leasing of Capital is then rather similar to an HP on the cattle with subtle and important differences, depending on the lease terms which can be more flexible than were the money to be accessed from a bank.

Advantages of being an INVESTOR

The role of the investor (buying in and leasing out dairy cattle) is an important one in the whole equation. Apart from earning a significant passive income, where the capital investment is growing at an agreed rate, this type of investment also has tax advantages. The capital investment is secured in the sense that the original number of animals is owed back to the Investor at the agreed value, irrespective of any mortalities.

How to find dairy cattle to lease out.

A person not acquainted with the dairy industry who wishes to buy dairy cattle for investment purposes, would require the services of a reputable and knowledgeable Dairy Cattle Broker to ensure appropriate value for money animals.

The Broker would make sure that the cattle are from a well managed farm where proper Veterinary protocols are in place. He would also do a valuation of the cattle and be of assistance in drawing up a contract between the two parties namely the investor (Lessor) and the dairy farmer (Lessee).

Some principles to take note of when investing in dairy cattle

Investment contracts, better known as lease contracts, are usually for between 3 and 5 years with the following options:

- To renew the contract for another term.
- The Lessee buys the cattle at a price agreed in the original contract.
- The Lessee returns the same number of cattle of equivalent quality and pregnancy status to the Lessor.

- The Investor sells the cattle to someone else, or places them elsewhere.
- Instead of receiving monthly payments, let the number of cattle grow at an agreed upon rate.

The Investor and Lessee should decide on the above matter at least 6 months before the end of the contract period.

Another important point is that the ownership of the original animals, or replacement animals, is acknowledged as belonging to the Investor (Lessor), and cannot be part of the Lessee's asset base or estate. It is recommended that the original animals be identifiable by means of the unique colour markings, photos, Tattoos and to a lesser extent, micro chips, electronic tags or visual tags. A current inventory of the animals should be available to the Lessor at any time with mortality or disposal reasons given.

Ways to structure the investment contract and returns that can be expected

The following methods are currently used in the leasing market and might be of assistance:

- An Investor (Lessor) can expect a return on investment of at least 2% above the prime lending rate, based on the value of the animals. For example: if an Investor bought animals for R10 000 each while the prime rate is 10% and the Lessor pays 12%, he would get $R10\ 000 \times 12\% / 12\ \text{months} = R100 + \text{VAT}$ per animal per month. All payments are on a specific date of each month on receiving a tax invoice. Payments usually commence one month after the heifers have calved. Returns on investment can be substantially higher, depending on the production systems and management capabilities of the Lessees.

It is recommended that the monthly payments increase annually by 5-7 % depending on the quality of the animals and farming operation. Alternatively the value of the animals should increase annually by 5-7% to avoid having to revalue the animals during or at the end of the contract term.

- Another option is to actually link the percentage payable monthly, to the prime rate. The income will thus fluctuate as the prime rate fluctuates.
- A popular option is that the Lessee pays an amount equal to the base price value of 1.5 – 3 litres of milk per cow per day. Should he receive R3.00 per litre for his milk and offer 2 litres, he would pay $R3.00 \times 2\ \text{litres} \times 30\ \text{days} = R180.00 + \text{VAT}$ per cow per month. In this instance the Lessee must send the Investor his monthly milk statement as received from his milk buyer, as the price paid for milk differs from buyer to buyer and also fluctuates during the course of the year.
- Where an Investor buys a herd comprising cows in different lactations and stages of lactation and then leases them out, it is recommended that the animals be equated to pregnant heifers in the contract. The formula below is an example of a way to establish the pregnant heifers equivalent to be returned at the end of the contract period: (At the same time a value should be placed on these heifers in case the Investor and Lessee agree that no heifers be given back but rather the monetary value.) Contact the author of this article on the formula used to determine an animal's value.

Cow lactation number:	Equated to pregnant heifers as percentage:
In calf heifers and 1 st lactation cows	100%
2 nd lactation cows	92%
3 rd lactation cows	84%
4 th lactation cows	76%
5 th lactation cows	68%
6 th lactation cows	60%
7 th lactation cows	52%
8 th lactation cows	45%

If no monthly payments involved, the heifer herd should escalate (grow) by 5 – 7% per annum (compounded).

In the case of a herd, all animals that had calved at least once, should be leased out with a clean bill of health as regards the udder status.

Should monthly payments be preferred, it should be based on the value of the cows and not the heifers as in the equation. In this case the investment contract should not be less than 5 years.

Available dairy breeds in South Africa

As in most parts of the world, the Holstein breed is the most popular and used more for investment purposes. In some parts of South Africa the Holstein is known as Friesland, although the Friesland is a different strain, it is not a different breed.

However in South Africa, the Friesland was registered as a breed on its own (scientifically wrong) in 2004. There are however very few typical Frieslands left in the country. They are the type that originated from the old FRS and NRS in Holland. There are also a few British Friesians in South Africa.

The second most popular breed is the Jersey along with Holstein x Jerseys crosses.

Other breeds are Ayrshire, Guernsey, Swedish Red, Dairy – and Brown Swiss, Montbeliard and Simentaler (Simmental). These are in the minority and not easy to find for investment purposes.

Following is an example of a lease agreement.

Compiled by: Gerrie du Preez

Updated: June 2011

AGREEMENT OF LEASE

MEMORANDUM OF AGREEMENT OF LEASE BETWEEN

.....
(hereinafter referred to as “the LESSOR”) of the one part;

AND

.....
(hereinafter referred to as “the LESSEE”) of the other part

NOW THEREFORE THESE PRESENTS WITNESS:

1. The parties to this agreement are:

Lessor:

Address:

ID Number:

Phone: Cell:

Bank details:

Bank:

Branch:.....

Branch code:.....

Account number:.....

VAT NR:.....

AND

Lessee:

ID Number:

Address:

Tel:

Email:

VAT NR:

2. The Lessor hereby leases to the Lessee who hires from the Lessor (**number**) **6 – 8 months pregnant Holstein heifers** described in the attached schedule hereunto annexed marked “A” in good and sound condition.
3. The agreed value of the livestock at the commencement of this Lease is calculated at (**R????**) per animal plus VAT.
4. The Lease shall be for a period of **THREE (3)** years commencing on **1 2011** and terminating on **31 2014**. For the duration of this lease, all cows are to remain on the farm
5. Payment by the Lessee to the Lessor will be no later than the **15th of each month**, on receiving an invoice from the Lessor. The first payment to be on **15 (???) 2011** which is calculated as follows:
 $R..... \times (???) = R????? \times ???\% / 12\text{months} = R????? \text{ per month.}$
6. The Lessee shall at all times maintain the animals in a healthy and sound condition, under his personal supervision. The cost of so doing shall be for the Lessee’s account. The Lessor or his representative shall at any reasonable time have the right to examine the livestock.
7. In the event of the death of any of the animals while in the possession of the Lessee, an animal of similar stature, breed, age and value shall be substituted for the dead animal by the Lessee and marked accordingly. It is expressly recorded that on possession of the animals the total risk thereto passes to the Lessee, notwithstanding ownership remaining vested in the Lessor.
8. Upon termination of this Lease the Lessee shall return to the Lessor heifers of similar type and quality to those hired at the start of this agreement, certified 6 – 8 months in calf to a Holstein bull.
9. The ownership of the livestock hereby leased shall remain vested in the Lessor and shall not pass to the Lessee.
10. The Lessee shall be entitled to retain as his own property the progeny of the said livestock.
11. The Lessee shall have no right whatsoever to cede his rights under this Agreement of Lease unless previous written agreement shall have been given by the Lessor to the Lessee in this regard.
12. In the event of non-payment of rent or any portion thereof on the due date, or of the breach of any other condition of this Lease, the Lessor shall have the right forthwith to cancel this Lease by registered letter addressed to the Lessee at, which address the Lessee hereby accepts as his domicilium

citandi et executandi and further to re-take possession of the livestock hereby leased without prejudice to any claim which the Lessor may have against the Lessee for any rent already due, or for any other damages that the Lessor may have suffered as a result of the termination of the lease, or non-fulfilment of conditions for the Lessee.

13. The parties agree that during the currency of this Lease the Lessee shall have the right to sell the livestock hereby leased as age of the livestock and marketing circumstances dictate, provided however that the number of livestock on hand shall never be less than **ONE HUNDRED PERCENTUM (100%)** of the total.
14. Should any dispute arise out of the contract between the parties hereto or any claim arise, the parties agree that the same shall be decided through arbitration by an arbitrator to be mutually appointed by them, who shall be the General Manager of the SA Holstein Society or his nominee, or a legal practitioner if the dispute relates to the interpretation of this contract. The Arbitrator's decision and any award made shall be final and binding on the parties who agree that any award made shall be enforceable as an award under the Arbitration Act and may on the application of any party be made an Order of Court and enforced as much under the provision of Act 42 of 1965, as amended.
15. The parties agree that in the event that any animals are to be re-leased, the Lessee is granted a first option to re-lease such animals.
16. The Lessor hereby grants the Lessee first option to purchase the animals referred to in this Lease agreement should the Lessor wish to sell any of the animals

Dated at.....on this..... day of..... 2011

AS WITNESSES:

1.

LESSOR:

2.

Dated aton this.....day of..... 2011

AS WITNESSES:

1.

LESSEE:

2.....

ANNEXURE A

The Lessor leases (???) pure Holstein heifers 6 – 8 months in calf to pure Holstein sires, with the following tag numbers:

- 1.
- 2.
- 3.