Proceedings of the 4th Biennial Conference
of the
African Farm Management Association

Farm and Farmer Organisation for Sustainable Agriculture in Africa

Edited by
Johann Laubscher

26 - 30 January 1998
University of Stellenbosch, South Africa

LAND REDISTRIBUTION IN SOUTH AFRICA - SOME PRACTICAL LESSONS

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ABSTRACT

This paper examines an innovative financial model successfully developed to enable people previously excluded from the land market in South Africa, with minimal equity to purchase land at market related land prices and interest rates. The paper then examines some of the practical problems and allied solutions associated with the implementation of the scheme and the development of appropriate support services and extension systems. Some feedback from the new farmers is also examined.

1. Introduction

The need for a rapid transfer of land to people previously excluded from the land market is critical for the long term political and economic stability of the country (Lyne, 1996 and van Zyl, 1994). It is also crucial that in ensuring that our extremely limited and fragile agricultural resources are used on a sustainable, efficient and productive basis, present and future consumers in an increasingly urbanised South Africa are protected.

One of the major stumbling blocks to a fast track programme is the serious financial constraint facing new entrants into the land market. Evidence from surveys conducted in South Africa indicates that the rental return to agricultural land is in the region of 5% per annum (Nieuwoudt, 1980; Hattingh, 1980), this is reinforced by evidence from North America and the United Kingdom. Further to this, South African monetary policy dictates that real interest rates are held at a positive rate of five percent above the inflation rate, which in South Africa is presently measured at ten percent per annum, thus the nominal interest rate is fifteen percent. Based on these figures and assuming that land is the farmer's largest asset, the farmer would have a cash flow problem with a bond of more than thirty three percent of the total land value (Nieuwoudt and Vink, 1995).

However, nominal returns increase over time with inflation, whereas nominal repayments remain constant if the bond on the land is not increased. The net effect is that the farmer's debt repayment capacity improves over time in line with inflation. Therefore, cash flow problems, which arise when land is financed with debt, can be removed by providing a finite and diminishing interest rate subsidy.

2. Criteria for successful land reform

The land reform programme requires that land should be used efficiently and sustainably, and to ensure that this happens three conditions need to be met. Firstly, incentives must be in place to encourage investment in, and conservation of, the land. Secondly, the investor must have the ability to finance these investments and improvements. Finally, an efficient market must exist to allocate land and other resources to the most efficient farmers.

Two broad types of land market can be distinguished. Firstly, land rental markets, which, if efficient, transfer land from individuals who are not able or willing to use their land efficiently to more effective users. Secondly, a land sale market, which creates a strong incentive for investors to conserve and improve land because the asset and the investment of capital into it can be liquidated at any time (Pasour, 1990). A productive agricultural sector will result from efficient land markets, as land will transfer to the most efficient users through rental transactions and the sale market will encourage owners to conserve and invest in their land (Lyne *et al.*, 1995 and Kille and Lyne, 1993).

Land markets require that the owner or user of the land have a full bundle of property rights, which are fully exclusive to the investor(s), are assured over time and are transferable. Studies in KwaZulu indicated that there is a strong positive correlation between investment in land and property rights, however as these rights are not necessarily transferable, the market is constrained and investment is sub-optimal (Kille and Lyne, 1993).

These conditions are necessary but not sufficient for investment (Place *et al.*, 1994 in Lyne, 1995). As the cash returns to farming are low, farmers are unable to finance all investment directly and require borrowings. Consequently, the collateral value of the farmer's land is vital. However land has collateral value only when it can be repossessed and sold on an active land market. The market system also has a spin-off benefit as it allows an objective market value to be attached to the land, which reduces information costs and facilitates sound investment decisions.

Transaction costs need to be kept to a minimum to ensure that the market is not constrained by costs, which may outweigh the potential benefits of the investment. These costs include survey, subdivision, transfer taxes as well as the cost of negotiating with the owners. The latter costs escalate rapidly with large and less organised groups of potential owners (Kille, 1993 and McHugh, 1980).

Strict enforcement of the sub-division of land adds considerable cost to land transactions and constrains the market. If, however, the land rental market is unconstrained, transaction costs are kept low and land is effectively zoned exclusively for agricultural use, the areas should respond to size economies.

Several criteria need to be met in order to promote sustainable market based land redistribution:

- Disadvantaged farmers must be given an opportunity to gain full access to the land market.
- The assistance given to the new entrants should minimise distortions to the land and capital markets.
- The new entrants must be given an opportunity to succeed as farmers with proper training, as well as financial and extension support.
- Private property rights need to be effectively assured by the State.
- Land zoning needs to be applied to prevent scarce agricultural resources from becoming residential areas.
- In addition, they must be able to cope with the initial cash flow problems associated with the purchase of land.

3. Background

The Board of a KwaZulu-Natal based sugar milling company took a strategic decision to focus on the company's key activities of cane procurement and the production of sugar and to dispose of some of their sugarcane estates.

The company has had considerable success with the development of small-scale sugar farmers and decided to sub-divide and sell sections of their estates to selected Black farmers. Their aim is to establish medium-scale, commercial Black farmers. The initial phase has been restricted to four estates, two in the midland area of KwaZulu- Natal, 1 on the south coast and 1 on the north coast.

The project thus far has settled 40 farmers on a total area of 3 841 hectares of land under sugar cane, the farm sizes vary from 58 to 216 hectares with an average farm size of 96 hectares. The total value of the land sold is approximately R40 000 000 or an average value of R10 300 per hectare.

4. Salient features of the transaction

The company selected the farmers from candidates who have indicated a desire to farm. Candidates also had to be able to make an own contribution of at least 10% towards the land purchase and pass an external credit check.

The growers obtained freehold title to the land. Of the transaction costs, the company has borne all survey and subdivision costs. However, the growers paid bond registration costs and certain other banking charges.

The farms have been planned and developed according to sound land use and conservation principles. Each farm has adequate infrastructure and buildings to ensure that the growers are able to begin operating immediately.

All of the contracting services to establish, maintain, harvest and transport the crop were initially supplied by the company; however, contractors from previously disadvantaged backgrounds have been established to take over these operations. The farmers control requests for and management of, these services. To assist farmers, the company and the South African Sugar Extension Service (SASEX) provide a comprehensive extension and advisory service. The grower services section of South African Cane Growers Association (SACGA) provides a bookkeeping service. A liaison committee has been be set up and includes the company, the farmers and the local farming community to involve and support the new farmers to ensure that problems are identified and addressed quickly.

5. Financial structure of the project

There are two methods for overcoming the cash flow problems associated with the purchase of agricultural land by people with limited equity to contribute to the purchase price. The first option is that disadvantaged farmers could be given a once off grant to offset the price of the land, to ensure that the bond is manageable within the farmers' cash flow constraints. On the other hand, the farmers' interest payments could be subsidised to an affordable level in line with the farm's cash flow.

Nieuwoudt *et al.*, (1994) and Nieuwoudt (1995) have shown that grant and interest subsidy impact on the cash flow differently, a once off grant of fifty five percent is insufficient to overcome the farmer's cash flow constraints in the first few years of operation. This exacerbates the problem that inexperienced farmers may well make poor management decisions during the first critical years after entry into the land market. An interest subsidy holding nominal interest charges to an affordable five percent is also an impossibly onerous fiscal burden over an extended period.

Nieuwoudt *et al.*, (1994) suggest that the subsidy could be phased out in line with inflation which would take approximately eleven years, when the rate of inflation is constant at 10 percent. This has several advantages in that the amount of subsidy is limited, the cash flow constraints are overcome and distorting effects on the land and capital markets are smaller than the distortions inherent in the grant system or an infinite interest subsidy.

The financial structure of the model employed in the programme uses the diminishing subsidy described by Nieuwoudt *et al.*, (1994), without resorting to State funding. The programme and model have the following features.

The grower is being expected to pay the full market value of the land, which will be financed by KFC. This value varies among the farms, as their productivity is not the same. The company will forgo eighteen percent of the market price. The funds from this discount are being placed in an account at Ithala Bank, which will earn interest at thirteen and a half percent. These funds, both the capital and interest, will then be used to fund a finite diminishing interest subsidy (Simms, 1996).

Interest is subsidised from the long term rate of 16.5 percent to 10 percent in the first year and the subsidy declines to zero over an estimated five years in line with a projected annual inflation rate of ten per cent. At this stage, no funds will be left in the Ithala account. The loan will be redeemed over a twenty-year period.

6. Financial results

In order to assess the financial success of the farmers their first year's financial results were compared with the budgeted figures. As can be seen, not all of the farmers have been able to keep adequate records and consequently some of the data was discarded as it distorted the results, although twenty of the farmers have only recently begun farming and as yet do not have sufficient records to analyse meaningfully.

Table 1: Salient financial indicators of the coastal farmers

Indicator	Budget	Actual
Total Number of Farmers	40	40
Number of Farmers with Records	20	12
Average Yield (Tons Cane)	47	53
Average Income (R/Ton)	113	108
Average Operating Costs (R/Ton)	62	89
Average Net Farm Income (R/Ha)	51	19
Average Drawings (R/Ha)	8	13
No of Farmers in Arrears	N/A	3

7. Problems encountered and some lessons learnt

Most of the requirements for successful land reform have been met by the project. The farmers have full, exclusive and a transferable right to their land. The land also has collateral value as the KFC have taken out bonds over the properties. However, the transaction and support costs are high, as much effort is being made to ensure that a healthy land market emerges from the programme.

This support is necessary to ensure that the farmers are able to make clear, well informed decisions about the future of their investment. The support and information from this is also being used by the financier to ensure that problems especially with the weaker farmers are identified earlier so that effective remedial action can be taken to preserve the value of the bonded asset.

7.1 Transaction costs

One of the criteria for successful land reform is that the transaction costs are kept low to ensure that transactions do not become so expensive that the benefits are outweighed by the costs of the deal. Unfortunately, there were several areas in which the transaction costs were particularly high and were it not for KFC, the company's commitment, and financial wherewithal the programme would not have been implemented. Some of these costs are outlined below.

The process of subdividing the farms proved more complicated and time consuming than was expected. The process has now been refined and enough time allowed, ensuring that it occurs timely. The registration of the properties and bonds proved to be problematic, as the applicants did not all meet their loan conditions on time. As a result more time has been allowed for this and deadlines have been set to ensure that corrective action is taken early.

The valuation of the farms has proved to be problematic, as the initial selling price and the loan finance were calculated on the productivity of the farm in terms of sugar cane production. A market valuation for each farm was obtained and, in some cases, considerable differences were noticeable due to localised eccentricities in the land market. The company, KFC (the financier) and SACGA (who represented the growers' interests) determined

compromise values. Initially this was a complex process but has now been streamlined.

Ensuring that the farmers' crop of sugar cane was insured against fire and Acts of God, caused considerable difficulty, as the insurance company insisted on ten metre fire breaks between farms which resulted in some of the growers having to take out cane. This has been resolved, but all future subdivisions will have to ensure that this is in place prior to the growers purchasing the farms.

The local commercial growers have also been particularly concerned that the growers were not keeping a regular fire watch over weekends. This resulted in one runaway fire. The growers now have a watch system and ISL has provided all the growers with radios so that they can be contacted in the case of a fire.

Considerable time and effort was used in ensuring that all the candidates had life assurance to cover the bond amount. Many of the candidates have heavily loaded premiums due to poor health, and several have been refused cover.

7.2 Support, training and extension costs

A bookkeeping system developed and run by the SA Cane Growers Association is being used to provide financial information to KFC and the growers. The implementation of this system has been problematic, with several of the farmers not co-operating in providing information for processing, as is illustrated in Table 1. KFC have developed set of financial reports based on information supplied by the SACGA bookkeeping system, KFC's statements, as well as crop estimates and physical management information. These reports will consist of the annual cash flow and balance sheet projection and in cases where the farmer appears to be in a vulnerable financial position a five-year cash flow projection as well as comments on the farmer's performance. This report will be produced each quarter and will be used to identify farmers requiring attention and remedial actions. Farmers who have no hope of financial success will be encouraged to sell their farms early to avoid severe financial losses.

Several auditing firms were approached to quote on providing an accounting and tax advice service to the growers, there was a good response from some of the growers but the same growers who have not provided information to SACGA have not made any arrangements with an auditor. This is an issue which has resulted from a distrust of the authorities, and an attitude which assumes that the less information supplied to the Receiver of Revenue, the less likelihood there is of prosecution. These attitudes will only be overcome with training and a realisation that more information available to a good advisor will in, fact, reduce the farmer's tax liability. The extension and bank staff will address this issue.

Formal training is an area that has been somewhat neglected and needs to be addressed. A schedule of courses has been designed for presentation over a day once every four to six weeks on the farms. These courses are being presented by a combination of SA Sugar Association extension staff, company, SA Cane Growers and KFC staff. These courses cover the following topics:

- Land preparation and planting
- Ratoon management
- Soils and fertilisation
- Principles and practices of mechanisation including costing
- The management and recognition of sugar pest and diseases

- The management of harvesting including, estimation, quality, ripening etc.
- Weed control and management
- Farm planning and soil conservation
- Farm and labour management
- Financial management.

A system of providing experienced farmers with a farm in the plan under the same financial conditions as the candidates, in exchange for an intensive mentoring role, has been implemented. These people are going to play a pivotal role in the success of this project. A lot of consideration has been given to finding the right kind of person to diligently monitor the farmers' progress, as well as being able to provide guidance and training that will ultimately make the grower independent of him.

This role has had several problems in the set up process. This situation arose largely because of a misunderstanding of the role. Those misapprehensions have been corrected by the creation of a clearly defined mentor agreement and reporting format. The person selected should not necessarily be a former employee of the company nor should he necessarily be White. Options to consider would be local commercial farmers as well as experienced Black employees with the right potential, ability and attitude.

7.3 Operational problems

As the farming units are too small to be able to carry a full complement of equipment due to adverse economies of scale, the company initially offered each of the groups of farmers a complete set of equipment at discounted prices. The equipment was then to be hired by the members at a set hourly rate, which would cover the operating costs. The farmers were required to form a co-operative, which in addition to purchasing the equipment, would purchase all their fertiliser and chemicals at the company's discounted rate. The co-operative would then sell the fertiliser and chemicals to the members at the normal price, the difference being used to pay for the equipment.

The growers, however, decided not to adopt the scheme and decided either to purchase the equipment individually and hire it to the other growers or to contract other people to conduct their operations. All of the growers were able to purchase second hand vans from ISL at highly discounted rates. This does not appear to have negatively affected their cash flows and does have a positive effect on their taxable position.

A Black entrepreneur approached the growers and has entered a contract to harvest and haul all of the farmers' cane to the Mills. SACGA have drawn up a standard contract to replace the existing simplistic and vague agreements, as considerable conflict has arisen over poorly defined roles and responsibilities, further exacerbated by the farmers' inability to work together. Numerous problems have emerged and these include:

- Large panels being burnt and insufficient cutters put into the field so that it takes several weeks to clear the cane, by which stage it is rotten.
- Inadequate and insufficient machinery being used to transport the cane, resulting in slow and inadequate extraction rates as well as delays and half loads for the haulier.
- Farmers not present at the zones when their cane is being loaded, resulting in misallocation and delays for the haulier.
- Inaccurate estimates submitted to the Mill Group Board and consequently the Daily Rateable Deliveries are inaccurate.

- The DRD's in turn are not checked and cane is left on the zone for weeks, resulting in a loss of quality or, at worst cane being rejected.

Some of the solutions, which have been applied to these problems, are outlined below:

- A strong and competent contractor who is trusted by the growers is contracted to carry out the harvesting and infield haulage for the farmers.
- The farmers, the contractor, the mentor farmer and a representative from KFC and ISL meet and plan a detailed harvesting programme at the beginning of the season.
- This plan is monitored on a weekly basis by the mentor farmer and new estimates and progress reported on monthly to KFC and ISL management.
- Should the harvester fall behind the schedule by more than ten percent his contract will be reviewed and replaced if necessary at the discretion of KFC, ISL and the growers.
- Smaller groups should be selected as the contractor is far more likely to be able to resolve disputes and enforce his contract with a smaller group of farmers.

The ratoon management however appears to be well under control, with the farmers all having ordered and paid for their fertiliser as per the Industry recommendations. This has been followed up with leaf testing to ensure that the crop has been adequately fertilised, having been initiated and supervised by the mentor farmer and will become the farmers' responsibility.

These decisions by the growers to invest in capital items are difficult to control and an ill considered decision will have a serious effect on the growers' financial position and, as a result, constant training with regards to financial management is important as well as monitoring the growers' financial position.

There are farmers who would appear to have jobs and accommodation elsewhere and are not resident on or near their farms. This situation has created considerable concern for the company, as they have always envisaged full time farmers on the land. KFC on the other hand is of the opinion that if the farmer feels it is necessary to have another form of income there is no problem. However, adequate measures in the form of either a proper lease or management agreement should be taken to ensure that the farm is properly run. This arrangement has the additional benefit of creating a vibrant land rental market, essential for efficient land use.

The problems of forcing people to either stay on the farms or to remove them, far outweigh the loss of a so called full time farmer, as long as arrangements are in place to ensure that the farm is well managed. It is important to supply some form of basic housing on or near the farm, which is included in the purchase price of the land, to enable the farmers to ensure someone is able to manage their farms.

8. Feedback from the farmers

An independent qualitative survey was conducted by an NGO to ascertain the feelings and attitudes of the farmers towards the scheme (Stewart and Msomi, 1997). The consensus was that the farmers were happy at the opportunity provided by the company and were very eager to succeed and that the problems were not insurmountable.

The problems included a perception that the farms had been deliberately run down by disgruntled company staff and were taken over by the new farmers requiring extensive replanting, weed control and fertilisation. There was also a perception that the farms had been placed as a buffer between the commercial farmers and the tribal areas.

There were also complaints about the harvesting and machinery arrangements, as has been discussed earlier in the paper as well as a general feeling of not being properly informed about the procedures of cane delivery to the mill. There was also a general reluctance to invest in fixed improvements due to a perceived risk of crime and violence.

Issues such as labour, neighbours, legal agreements and leases were not seen as a problem. A great deal of ignorance and suspicion exist around the formal sector requirements of the payment of taxes and levies, being an area where much mentoring is required and this reflects a larger problem associated with the transformation of South African society.

9. Conclusion

This financial structure has several benefits to both the grower and the financier:

- The cash flow in the first vulnerable years is boosted, giving the financier and grower added security.
- Distortions to the market values of farmland are minimised. Although the subsidy will tend to be discounted into the land price, this distortion is far lower than that of a grant subsidy, especially since the grant would have to be considerably larger than 18 percent to eliminate the cash flow problems.
- A grant may encourage opportunists to immediately capitalise their subsidy by selling the farm and pocketing the subsidy.
- The cash deposited in the bank also gives added security if the grower does default.
- The services to be provided by the company, the sugar industry, the community and the financier will ensure that the new entrants are given all the support required to ensure their success.
- The title-deed, which the growers will receive, will enable them to participate in the land market although the high initial transaction costs associated with the purchase of land may not make selling economically feasible. This will not preclude their participation in a rental market nor will it restrict the secondary land market ensuring an active rental and sale market.

Apart from these advantages the majority of the problems associated with this project are of a facilitative nature, ensuring that the farmers are supplied with sufficient information, training and support to be able to make the most efficient arrangements to manage and grow their investments. The adverse economies of scale have ensured that considerable effort and cost has been expended on negotiating suitable arrangements with one another.

The financial analysis, although not as complete or thorough as is desirable, indicates clearly that, although the farmers have had better yields than anticipated, their financial performance has been poorer than expected, with income down and costs and drawings up. Thus, a conservative approach to planning the financial structure of these projects is critical.

As Vaughan (1997) points out the financial structure of the project could be applied to State land to facilitate its redistribution. However, consideration needs to be given to smaller units of land to increase the number of beneficiaries but this will need to be allied to other

economic opportunities, which will allow the beneficiaries to conduct multiple livelihood strategies.

This model could well be applied to State land. If the land were sold at market values with the State forgoing a portion of this value to enable financiers to offer a finite and diminishing subsidy, there would be no impact on the State's constrained cash reserves. In fact, the State would receive a considerable cash injection from the privatisation of its land. A limited lease period could be agreed to at a rental rate, which would enable the entrants with little or no equity to build up sufficient cash reserves to obtain finance to exercise their option to purchase.

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