A FINANCIAL MODEL TO FUN
SUGAR INDUSTRY OF KWAZU

P. Simms
KwaZulu Finance and Investment Corporation

This article examines the requirements for successful re
model used to successfully finance emerging commercia
by the seller to subsidise the interest rate on the bond or
flow problems associated with agricultural land purchase
land transactions with very limited impact on the fiscus,

1. INTRODUCTION

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

This paper examines a model which has been used to successfully provide finance for the purchase of miller come planter (MCP) owned sugar cane farms in the KwaZulu-Natal midlands and north coast. This model has however the potential to be utilised for other State and private land redistribution initiatives which seek to give emerging farmers an opportunity to obtain commercially viable farms.

Evidence from surveys conducted in South Africa indicate that the rental return to agricultural land is in the region of five percent per annum (Nieuwoudt, 1980; Hattingh, 1980). If real interest rates are held at a positive rate of five percent above the inflation rate and inflation is measured at ten percent per annum the nominal interest rate will be fifteen percent. Based on these figures and assuming that land is the farmers largest asset, the farmer would have a cash flow problem with a bond of 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 farmers 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

A productive agricultural sector is dependant on efficient land markets (AID, 1986, Lyne *et al* 1995 and Kille and Lyne, 1993). A land rental market will transfer land from individuals who are not able or willing to use their land efficiently to more effective users. A land sale market creates a strong incentive for investors to conserve and improve land because the markets,

- the new entrants must be given an opportu succeed as farmers with proper training, as v financial and extension support,
- private property rights need to be effe assured by the State,
- land zoning needs to be applied to prevent agricultural resources from becoming resi areas,
- in addition, they must be able to cope wi initial cash flow problems associated wi purchase of land,

3. BACKGROUND

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

The company has had considerable success wi development of small scale sugar farmers and dec sub-divide and sell sections of their estates to se black farmers. Their aim is to establish medium commercial black farmers. The initial phase ha restricted to three estates, two in the midland around Umbumbulu and Mid-Illovo and one Shakaskraal area on the north coast.

4. SALIENT FEATURES OF PROPOSED TRANSACTION

The farmers will be selected by the company candidates who have indicated a desire to farm fu Candidates must also be able to make an contribution of at least ten percent towards th purchase and must pass an external credit check.

The growers will obtain freehold title to the land. transaction costs, the company will bear all surv subdivision costs. However the growers will h carry transfer fees, bond registration costs and banking charges.

The farms have been planned and developed acc to sound land use and conservation principles. farm also has adequate infrastructure and buildi ensure that the growers are able to begin op immediately.

The company will initially supply all of the cont services to establish, maintain, harvest and transp crop, requests for and management of these servic be in the farmers hands. To assist farmers, the co and the South African Sugar Extension S (SASEX) will provide a comprehensive ext and advisory service. A bookkeeping service w provided by the economics section of South A Cane Growers Association (SACGA) and a committee will be set up with the company, the g and the local farming community to involve and s the new farmers to ensure that problems are ide and addressed quickly.

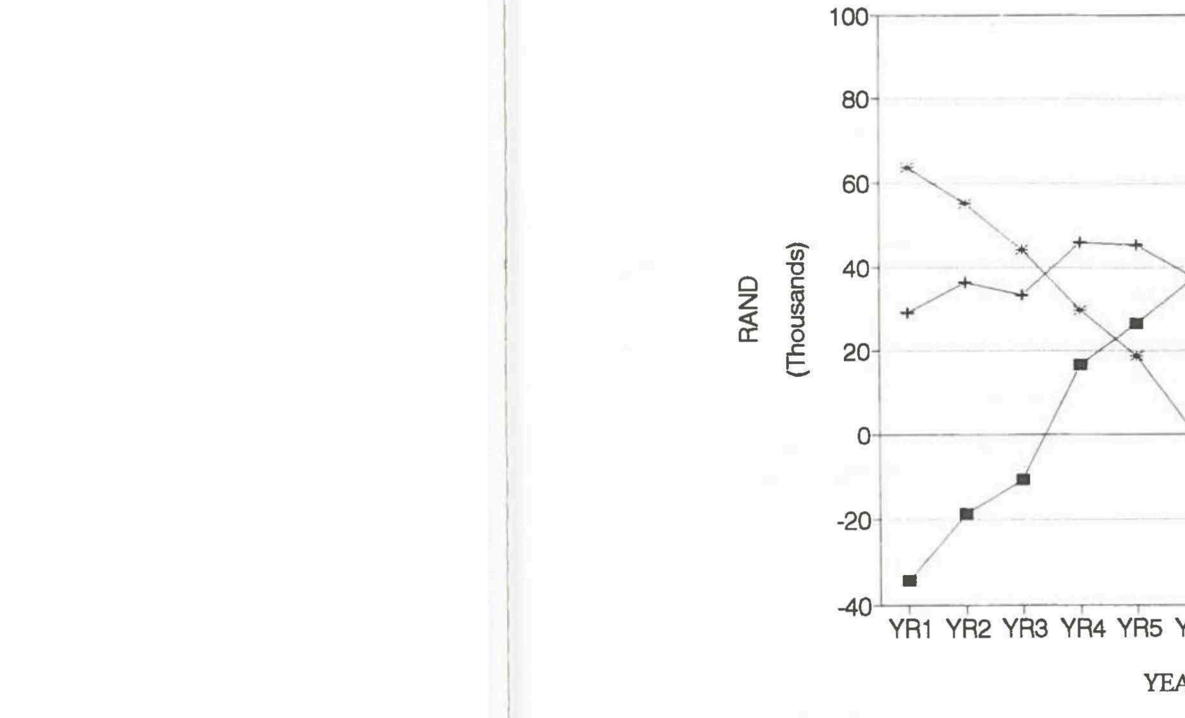

Figure 1: **Funds flow**

Table 1: **Salient Financial Indicators**

Indicator
Total Area of Farm
Market Value of Land
Total Subsidy (NPV to Mill)
NPV of Subsidy to farmer
20 Year IRR Before Finance
20 Year IRR After Finance
Cash on Hand Year 2
Cash on Hand Year 5
Cash on Hand Year 10
Cash on Hand Year 20

The model has also been tested by simulating inflation rates varying from five percent to twenty five percent. It was found that the cash flows remained positive and that the amount of capital sacrifice did not need to be altered. However, the relationship between inflation, saving, lending and subsidy rates was held constant.

These figures clearly indicate that although the grant subsidy provides a slightly better 20 year internal rate of return (IRR). The subsidised interest rate performs better in two critical areas. Firstly for the same initial amount of subsidy the net present value (NPV) of the interest subsidy to the farmer is 16% higher than that of the grant subsidy. This extra value translates into the second area of benefit which is a far better cash flow situation in the first five years. The grant scheme is unable to sustain itself in it's first two years of operation and is very vulnerable to slight fluctuations in net income in the first five years.

- the cash deposited in the bank also gives security if the grower does default,

- the services to be provided by the compa sugar industry, the community and the fi will ensure that the new entrants are given support required to ensure their success,

- the title-deed which the growers will recei enable them to participate in the land although the high initial transaction associated with the purchase of land may no selling economically feasible, this will not p their participation in a rental market nor restrict the secondary land market ensu active rental and sale market,

This model could well be applied to State land land is sold at market values with the State for portion of this value to enable financiers to offer and diminishing subsidy there would be no im the State's constrained cash reserves. In fact th would receive a considerable cash injection fr privatisation of it's land. A limited lease period c agreed to at a rental rate which would ena entrants with little or no equity to build up su cash reserves to obtain finance to exercise their o purchase.

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