University of Idaho
College of Agriculture
Cooperative Extension Service
Agricultural Experiment Station
Current Information Series No. 411
October 1977

Guidelines for Farm Leases

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A substantial part of our agricultural land is farmed by tenants. The 1974 Agricultural Census indicated that a little over 31 percent of the farmland in Idaho was rented.

Table 1 gives a breakdown of percentages of farms and farmland held by full owners, part owners and tenants in 1969. The distribution of ownership types was essentially the same for the United States and for Idaho. Note that in Idaho 34 percent of the farmers were part owners, meaning part of the land they farmed was rented and some was owned. Another 12 percent rented all of the land they farmed so, overall, 46 percent of the farmers in Idaho were involved with farm leases in 1969. This does not include full owners who rented part of their land to someone else or pasture leases negotiated by the number of animal units rather than acres.

These statistics emphasize the importance of farm leases in Idaho and in the United States.

With so much land rented one would suspect that a great deal of knowledge about leases would be available. Information is available, but seldom in a form readily usable by parties to the lease. As a result, many farm leases are very poorly written or not written at all. This report offers some guidelines and suggestions for landlords and tenants to consider in making a lease.

Why Farm Leases?

Farm leases are used because they can be advantageous to both the landlord and the tenant. The reasons landlords are interested in leasing rather than selling the land are varied but most fall into the following categories.

1. Land is held as a hedge against inflation. Value of land rises as value of money declines.
2. Land is held as an investment. Rent is the return on the investment.
3. Land is held for posterity. Children or grandchildren may want to farm in the future.
4. Land may be held rather than sold in order to postpone capital gains taxes.
5. The farm operator may wish to retire but wants to maintain ownership and partial control of the farm.
6. Professional people or corporations may become landlords for diversification of investment or for possible tax advantage.

Farm leases also offer possible advantages to tenants. Land is expensive and its purchase ties up large quantities of capital. A farmer may be better off if he invests his limited capital in machinery and other productive inputs and rents land from someone else. Possible advantages to the tenant include:

1. Less capital is required.
2. Renting additional land may increase volume of output and net income.
3. Renting land may be a means for young farmers with limited capital to get started.
4. Renting provides greater flexibility, making it easier to move to a different farm.

Types of Leases

Several types of leases can be used on the farm. The most common in Idaho are the crop-share lease and the cash lease.

The crop-share lease is most popular in Idaho probably because it allows the landlord to share in management decisions. Risks associated with crop failure and price

Table 1. Percentages of farm and acreage for three tenure classes in the United States and Idaho, 1969.

Tenure class	United States (48 states) % of farms	United States (48 states) % of land in farms	Idaho % of farms	Idaho % of land in farms
Full owners	51	29	54	30
Part owners	33	57	34	61
Tenant	16	14	12	9
Total	100	100	100	100

Source: 1969 Census of Agriculture. Dept. of Commerce Bureau of Census.

decline are shared by tenant and landlord. The crop-share lease is usually preferred by young tenants and others who do not have large capital reserves.

Cash rent has gained some popularity since 1970 and may be preferred by landlords who desire a steady income from their farming enterprise. Tenants with experience who are in sound financial condition often favor cash leases because they permit more freedom in management decisions and rent payments are the same regardless of production. This provides greater incentive to increase production than if commodities produced were shared with the landlord. Cash rent is usually slightly less than share rent because the tenant bears the risk of production and price changes.

Some leases combine share and cash leasing with the crops rented on a share basis and cash rent paid for the dwelling and buildings. Pasture is also often rented on a cash basis.

The fixed-product lease is one in which the tenant pays a specified amount of product as rent rather than cash. For example, the rent may be 40 sacks of potatoes, 25 bushels of wheat or 2 tons of hay per acre — or a fixed amount of whatever commodity is produced. The rent is fixed in terms of product rather than market price of the product.

Contract farming is another possibility open to the landlord. With this method, he contracts with an operator to do his farming according to specifications. The landlord retains most of the risk with this method.

Guidelines for Lease Arrangements

Leasing is much like marriage. It is a contract entered into with optimism by both landlord and tenant. Yet, in both cases, trouble may arise in the relationship. Some precautions can be taken that will increase the chances of success of the leasing arrangement.

Many leasing negotiations take place between neighbors or people in the community who know each other quite well. Most problems occur with these leases. Neighbors or acquaintances are likely to be less cautious and less thorough in defining details of the lease and, since they trust one another, may feel a detailed, written lease is unnecessary.

Verbal leases are still quite common in many areas of Idaho. However, leases need to contain enough detail so that each party knows his rights and what is expected of him. Verbal leases are usually short on details and are difficult to handle when problems arise. Consider these suggestions when making a farm lease:

1. The lease should be written, dated and then signed by all parties.
2. An attorney should be consulted so the wording of the lease will be legally binding. This protects the rights of both parties. Leases are frequently notarized and recorded at the county courthouse.
3. The lease should include:
   - Names of those involved.
   - Date of lease and period to be covered.
   - Date when tenant is to take possession of property.
   - Description of property to be leased.
   - Amount of rent to be paid — in what form, when and where; what is to be furnished by the landlord and by the tenant and how production decisions are to be made.
   - Rights reserved by landlord — right of entry, inspection, etc.
   - Restrictions on tenant such as rotation to follow, maintenance levels on property, control of weeds, conservation practices.
   - How and when lease may be terminated by either party.
   - How tenant will be compensated for any improvements made for which value extends beyond termination date.
   - Rights held by heirs of landlord and tenant should either die or become incapacitated.
   - Procedure for settling disputes between parties.

Equity in Leases

Problems in negotiating farm leases commonly arise from too much reliance on local customs, unrealistic income expectations, failure to provide for needed improvements on the farm and failure to reward the parties to the lease in relation to their contribution to production. These problems should be resolved before lease negotiations are completed.

In the case of the share lease, both parties should determine first how the farm ought to be operated for maximum net returns. Then they can determine which inputs will be provided by the landlord and which by the tenant. Next, a budget of production costs should be worked out in sufficient detail to determine what part of costs will be contributed by each party. Gross returns from sale of goods should be divided according to the contribution of each.

Contribution to the farm business should vary according to the abilities and resources of each party to the lease. The landlord contributes the land and nearly always pays the real estate taxes. The tenant provides labor and usually machinery. Contribution to production can be divided any way agreed upon by the landlord and the tenant.

The inputs to be used on the farm may be classified as follows:

Fixed inputs

Land and buildings
Machinery and equipment
Breeding stock

Fixed costs

Labor
Depreciation
Taxes
Insurance
Conservation expense

Variable costs

Seed
Fertilizer
Fuel
Utilities
Seasonal labor
Chemicals
Machine work hired

Table 2 shows one way to determine the contribution of each party and to divide the proceeds. Who contributes what is not important as long as the farm is operated at top efficiency and returns are divided on the basis of contribution.

Cash rent can be calculated similarly. If the rate is set at the time the contract is prepared, an estimate of production and prices will be needed. An allowance for management should be allocated to the tenant unless the landlord participates. With cash rent, the tenant will usually pay all variable costs. If so, the proportion contributed should be based on total production costs including variable costs. An alternative would be to calculate the value of the landlord's contribution and agree on a fair rate of return on his investment.

Table 2 is an abbreviated version of a rent estimation table adapted from USDA Miscellaneous Publication 838, "Your Crop-Share-Cash Farm Lease". The total of sections 1 and 2 in Table 2 provides the basis for sharing farm income. Variable expenses should be shared at the same percentage as fixed expenses. For example, if the landlord's contribution in sections 1 and 2 were 41 percent, he should pay 41 percent of the variable expenses and receive 41 percent of the income from the farm. If the tenant's contribution is great, his share of the returns would be large. Each is paid according to his contribution. The farm house could be rented separately to the tenant for cash since it is not a part of the farm production base.

The reasons for calculating rent according to landlord and tenant contribution is that no two farms are exactly

Table 2. Table for Estimating Rent

Item	Estimated annual cost		
	Whole farm	Landlord's share	Tenant's share
1. Fixed investment expense			
Land and buildings (value X interest)[1] $300,000 X .08	$24,000	$24,000	
Machinery and Equipment (value X interest)[2] $85,000 X .08	6,800		$ 6.800
Breeding stock (value X interest)[2] $100,000 X .08	8,000		8,000
Operating cash (value X interest)[3] $75,000 X .09	6,750		6,750
Total	$45,550	$24,000	$21,550
2. Fixed operating expense			
Labor: Tenant and family[4] 2500 hr. @ 3.50 Landlord	8,750		8,750
300 hr. @ 3.50 Other	1,050	1,050	
Depreciation: Machines and equipment Permanent improvement[5] (actual depreciation)	9,200	600	8,600
Repairs: Machines and equipment Permanent improvements	4,500	500	4,000
Taxes	2,500	1,900	600
Insurance	1,100	1,100	
Irrigation fees	500	500	
Conservation expenses	2,100	1,700	400
Management[6]	900	100	800
Total	$30,600	$ 7,450	$23,150
Total of sections 1 and 2	76,150	31,450	44,700
Percent contributed	100	41	59
3. Variable expenses[7]			
Hired labor	2,700		
Machine operating costs	5,970		
Machine work hired	2,310		
Seed	3,200		
Fertilizer	6,000		
Chemicals	1,500		
Feed and Veterinarian	7,240		
Utilities	3,680		
Total[8]	32,600	13,366	19,234
Grand Total[9] Sections 1, 2 and 3	$108,750	$44,816	$63,934

[1] Annual cost of land and buildings is the value multiplied by the interest rate. The income value of the farm should be used. The assessor uses the income value in calculating taxes in Idaho. His value may be used as a starting point in this calculation. Use the current interest rate for farm real estate loans.

[2] The annual machinery cost is the present value multiplied by the rate of interest for intermediate credit. Breeding stock cost is found the same way.

[3] Operating cash cost is the amount times the interest rate for operating credit.

[4] Labor is calculated at the local rate for full time farm labor.

[5] Depreciation and repairs are estimated from previous records if available. Otherwise an estimate of anticipated depreciation and repairs is made.

[6] Management is difficult to estimate but should be considered. A per acre figure can be used or five percent of the average gross income for the past three years.

[7] Variable expenses are estimated from previous records or budgets of cost.

[8] The variable expenses are shared between landlord and tenant at the same rate as the fixed expenses are shared. If this is not feasible then the rate at which returns are shared should be adjusted accordingly.

[9] If the gross income were $120,000, the tenant would receive $70,800 (.59 X 120,000). His net return would be $6,866 plus the interest on this equity in fixed assets (70,800 - 63, 934).

alike. Each leasing arrangement should be calculated separately to avoid too much reliance on local custom, which may not be equitable. Using a budget takes considerably more effort than the traditional approach. However, the budget gives both the landlord a better idea of what is involved and provides a more equitable means of dividing income. This procedure can be modified if either the landlord or tenant were in a particularly strong bargaining position. If the landlord contributes only the land, his returns would be smaller.

If you are a landlord or a tenant, consider the leasing arrangement carefully and spend whatever time is necessary to make it a good one. Remember, your lease should:

- be written and legally binding.
- be equitable.
- encourage efficient production.
- allow for necessary farm improvements, equipment and conservation measures.
- specify how decisions are to be made.
- provide for termination when desirable.
- clearly state the rights and responsibilities of both landlord and tenant.

The following publications may be helpful to those negotiating a lease. Your local County Extension Agent may have some of these publications or you may obtain them from the Superintendent of Documents, Government Printing Office, Washington, DC. 20402.

Your Farm Renting Problem, Farmer's Bulletin 2161
Your Farm Lease Contract, Farmer's Bulletin 2164
Your Farm Lease Checklist, Farmer's Bulletin 2163
Your Cash Farm Lease, USDA Misc. Pub. 836
Your Livestock-Share Farm Lease, Misc. Pub. 837
Your Crop-Share Farm Lease, Misc. Pub. 838

10 cents per copy

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5M 10-77