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Creating a healthy farm lease

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During 1987, 40 percent of Idaho's privately owned farmland was leased, and 54 percent of Idaho farm operators with gross sales of $10,000 or more were involved with farm leases. The *Census of Agriculture* divides land tenure into three categories: full owner (full owners own all the land they operate), part owner (part owners rent part and own part of the land they operate), and tenant (tenants rent all of the land they farm). The proportions of all Idaho farms and acres in each category appear in Table 1. Farms having $10,000 or more annual product sales are included in Table 2. While farms with annual sales below $10,000 were 43 percent of the farms, they accounted for less than 14 percent of the total acres.

Survey of Idaho cropland leases

A detailed study of farm cropland leases in seven major agricultural counties in Idaho revealed some of the characteristics of Idaho farm leases. The seven counties included in the study were Bingham, Canyon, Cassia, Latah, Minidoka, Twin Falls, and Washington (Fig. 1). A random sample of leases was drawn and lessees were contacted for information. Many similarities and some differences between counties were found. *Economic and Legal Considerations for Leasing Cropland in Idaho* by Seavert, Withers, and Grant (Idaho Agricultural Experiment Station bulletin 579) gives a more detailed report of the county data.

Table 1. Number of farms and acreage by tenure class, Idaho, 1987.

	Farms		Acres	
Tenure class	**Number**	**Percent**	**Total**	**Percent**
Full owner	14,406	60	4,759,865	34
Part owner	6,817	28	7,647,839	55
Tenant	2,919	12	1,524,171	11
Total	24,142	100	13,931,875	100

Source: U.S. Dept. of Commerce. Bureau of the Census. 1987. Census of Agriculture. Vol. 1, Part 12, Idaho state and county data. U.S. Government Printing Office, Washington, DC.

Table 2. Number and acreage of farms with annual sales of $10,000 or more by tenure class, Idaho, 1987.

	Farms		Acres	
Tenure class	**Number**	**Percent**	**Total**	**Percent**
Full owner	6,275	46	3,938,963	33
Part owner	5,316	39	6,903,085	57
Tenant	2,076	15	1,198,618	10
Total	13,667	100	12,040,666	100

Source: U. S. Dept. of Commerce. Bureau of the Census. 1987. Census of Agriculture. Vol. 1, Part 12, Idaho state and county data. U.S. Government Printing Office, Washington, DC.

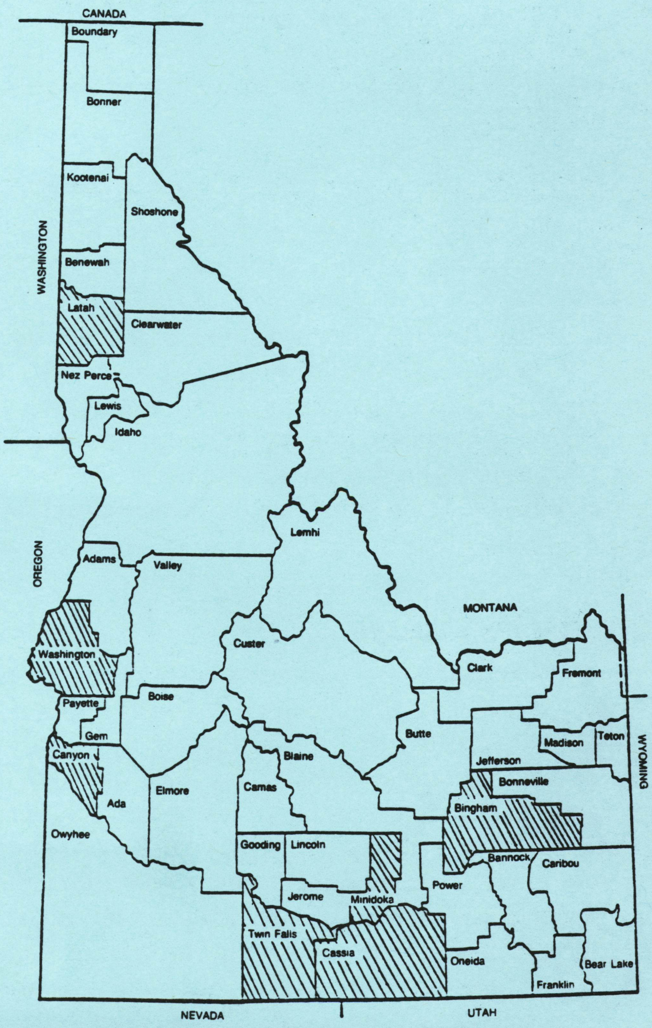

Fig. 1. Counties surveyed for farm lease information.

Even though there are other types of leases, all of those reported in this study were fixed-cash or crop-share leases. Two-thirds of all leases were crop share. The most common share lease was a 50-50 split between the landlord and tenant. The next most common share was one-third to the landlord and two-thirds to the tenant. Shares paid for rent depended on the crop, traditional local rates, and what was contributed by the parties involved in the lease.

About one-third of the leases were cash — mostly fixed cash payment. The average cash payment per acre was $80. However, there was considerable variation depending on whether the cropland was irrigated or dry, how the productive inputs were shared, and the type of crops involved. Average cash rents ranged from $42 per acre in Latah County to $104 in Canyon County.

Many of the leases (65 percent) were automatically renewable at the end of the leasing period. The lease continued, according to the agreement, if neither the landlord nor tenant requested renegotiation. Thirty-five percent of the leases called for renegotiation at the specified termination date. While most automatically renewable leases were for 1 year, about 40 percent of the respondents said they preferred leases for 2 years or longer. Longer leases lend stability and facilitate planning by the tenant for future production. Landowners may favor a 1-year or year-to-year lease until a comfortable relationship with the tenant is established.

Only 51 percent of the leases were written, while 49 percent were verbal. This is surprising when one considers the possible pitfalls related to a verbal lease. Attorneys were involved in writing or reviewing 22 percent of the leases.

Government program payments were shared the same as crops produced where share leases were used. If the lease specified a fixed cash-rent payment, the tenant usually received the government payment. Arrangements for Conservation Reserve Program (CRP) land depended on the participation of the landowner in establishing cover crops and controlling weeds.

Cash-rent leases

A fixed cash lease is the most straightforward, with tenants paying an agreed upon sum of money for the use of property. The payment can be made in any fashion, but the most common are one single payment or two equal payments per year. The single payment may be paid in advance, part way through the year, or at the end of the harvest period. Normally, the landlord wants to receive the payment as early as possible and the tenant wants to delay the payment as late as possible. Late-payment rates should be larger than early ones to reflect the time value of money and because the later payment increases the landlord's risk. Data from the leasing study did not establish whether there is a relationship between time of payment and rental rates paid.

Crop-share leases

Share lease payments consist of an agreed upon share of the crop to be paid to the landlord. The value of the payment depends upon the crop yield and the market price of the commodity. The landlord shares the risks related to crop yields and prices along with the tenant. If yields are high and prices are good, the landlord may do better than he or she would with a fixed cash lease. If yields are poor or prices are low, the landlord's return reflects this as well. Also, with the share lease the landlord is usually more involved in planning and management decisions. Marketing decisions are usually made by landlords and tenants independently of each other for the share of the crop owned.

Landlord expenses

The landlord has some expenses whether the lease is cash or share. Expenses with fixed cash leases are usually minimal: real estate taxes on land and improvements, some maintenance costs, and insurance on improvements. Where irrigation is involved, the landlord usually pays water fees and often provides the sprinkler system. Share-lease landlords pay all expenses normally covered by cash landlords plus any expenses agreed upon by the lease parties. Often the landlord pays a share of some of the production expenses. For example, in Latah County it is quite common for the landlord to pay one-third of the cost of fertilizer and chemicals when he or she receives a one-third share of the crop. With a 50-50 lease, the landlord pays more of the production expenses. However, there is no hard rule on this, and arrangements need to be negotiated between the parties to the lease.

Leasing problems

Problems associated with farm leases were identified by Withers and Grant in a previous study (Idaho Agricultural Experiment Station bulletin 579, *Land Tenure and Leasing in Idaho Agriculture: Economic and Legal Considerations*). Some of those most frequently mentioned by respondents were:

- Unwritten leases
- Poor management by tenant
- Inappropriate lease period
- No provisions for maintenance of improvements
- Inadequate soil conservation practices
- No provisions for update and review of lease
- Failure to provide for weed control
- Unrealistic expectations by either party
- Rights and responsibilities not identified
- Inequitable rent payment
- Dependence upon local custom
- Lack of communication between landlord and tenant

This list emphasizes two major points that need consideration. First, a lease should be written and clearly identify the rights and responsibilities of each party, including how and when rent payments are to be made. Second, rent payments should be fair and equitable. This means that the income produced by this property should be divided between the landlord and tenant in proportion to the contribution toward production by each of the parties.

What should be considered in a lease?

A lease is a contract between a property owner (lessor) and a tenant (lessee). This is so whether the lease is written or verbal. The written lease is far superior because it is a record of what each party has agreed to do. Also, parties involved with a written lease are more likely to give careful consideration to the details of the lease. A written lease would include the following items plus other details deemed important by the parties:

1. Identification of the parties.
2. A legal description and location of the property being leased. This includes land, improvements, and other resources, if any.
3. Rights and obligations of each party.
   a. Right of entry by landlord.
   b. Sublease rights.
   c. Arrangements applicable if farm is sold.
   d. Continuation if either party dies or becomes incapacitated.
4. How land will be used and who will make decisions; to what extent is landlord involved?
5. Tenant's obligation to maintain property, control weeds, conserve soil, and protect the property.
6. Provisions for adding improvements needed for optimum production and compensation to tenant when improvements added by him or her continue after lease termination.
7. Whether a residence or other buildings on the property are included in the lease.
8. Manner in which the tenant will use the property — practices to follow, crop rotations, adherence to accepted farming methods.
9. Rental rate and how determined.
10. How, when, and where rental payments are to be made. With cash rent, the dates of payment should be specified. With share rent, the time and place of commodity delivery of the landowner's share must be specified.
11. Expenses to be paid by landlord.
12. How to handle crops that have not yet been harvested by the lease termination date.
13. Recourse by tenant or landlord if terms of the agreement are violated.
14. Date the tenant may take possession of the property and also the termination date.
15. If, and under what conditions, the lease is renewable.
16. Conditions in which the lease can be terminated before the date specified.
17. Signatures of landlord and tenant, preferably notarized, and date of signing.

Lease equity

Equity in a lease merely means that each party is rewarded according to his or her contribution. If a tenant contributes 70 percent of the cost and resources to the production of a commodity, he or she should receive 70 percent of the crop or its value. It is not always easy to estimate an equitable lease. This accomplishment is based on the premise that the contribution of each party can be fairly evaluated. Access to a good set of records and cost budgets are needed for adequate rent calculations.

Normally, the landlord furnishes land and improvements, including real estate taxes and maintenance, and some management plus other agreed upon expenses. The tenant provides labor, equipment, management, and part or all of the operating expenses. The actual amount of rent agreed upon may vary depending on the demand and supply of rental property as well as the calculated equitable rate.

An example of calculations for contributions by a landlord and tenant is shown in Table 3. First, the total cost

Table 3. Example of estimating the share of the cost contributed by parties to a lease.

Costs	Farm	Tenant	Landlord
Fixed			
Land[1] ($300,000 @ 8%)	$ 24,000	$ 0	$24,000
Taxes (300 acres × $5/acre)	1,500	0	1,500
Machinery[2] ($140,000 @ 10%)	14,000	14,000	0
Buildings[2] ($50,000 @ 8%)	4,000	0	4,000
Irrigation equipment[2] ($65,000 @ 10%)	6,500	3,000	3,500
Management[3]	10,000	6,000	4,000
Water fees	3,000	0	3,000
Insurance	2,000	1,500	500
Operating			
Seed	12,000	12,000	0
Fertilizer	14,500	10,500	4,000
Fuel	3,600	3,600	0
Chemicals	12,000	8,000	4,000
Maintenance	1,200	200	1,000
Labor	28,000	28,000	0
Custom hire	11,000	10,000	1,000
Supplies	8,500	8,500	0
Miscellaneous	1,600	1,400	200
Total	157,400	106,700	50,700
Percentage of expenses paid	100%	68%	32%

[1]This is production value of the land or the rate determined by the county assessor for tax purposes. It is usually below the market value.

[2]Machinery, buildings, and irrigation equipment are valued at their present value.

[3]An amount agreed upon between landlord and tenant.

of farm production, including fixed and variable costs, is estimated for the year. Then the portion of that cost contributed by each party is estimated. The figures are totaled and the percentage of the total contributed by each party is calculated. This percentage is used to determine the share of production that is to be paid by the tenant. In the example, this is 32 percent or nearly one-third of the crop.

If this were a cash lease, it would be necessary to estimate a normal value for the crops produced. A normal value estimate may be made by using a 5-year average of yields and prices to get the expected gross return to the property. Another way to estimate cash rental rates would be to determine the percentage of farm value that typical landlords in the area have been receiving as cash rent after necessary expenses. This percentage is multiplied by the market value of the property to get the rental rate. Landlord and tenant would adjust this rate to fit the farm being rented.

For example, suppose that the area rate of return to land is 6.5 percent of the market value. The value of the farmland is determined to be $260,000 for 300 acres. The cash rent would be $16,900 for the year or about $56 per acre. In some cases, it may be necessary to get an appraisal of the property to determine its value. This approach, as with other cash leases, establishes the return to the landlord, and the tenant bears the risk of low yields or prices.

A computer program is also available for calculating cash or share lease payments. This program, "Landrent," by Gayle Willett, is available from Bulletin Office, Cooper Publications Building, Washington State University, Pullman, Washington 99164-5912 for $25.00.

Supply and demand

After the equitable lease rate is determined, there may be some additional adjustment to reflect the local supply and demand conditions for cropland. If there are several farm operators who would like to rent land and only a small amount of land is available for rent, the landlord may be able to get a somewhat larger rental payment — especially if rates are determined by bid. If the opposite is the case, the landlord may be required to reduce rental rates in order to attract a suitable tenant. On the other hand, landlords or tenants may be willing to make some concessions if a good relationship between the parties has developed and both are happy with the arrangements.

Legal protection

It is usually desirable to have a lease reviewed or written by an attorney familiar with farm lease arrangements. This will reduce the chances of problems later on if conflicts arise between the landlord and tenant. Important items that may have been overlooked can be included before finalizing the lease. Since an attorney represents either the landlord or the tenant, each party should have his or her attorney review the lease. It would be worthwhile to become familiar with general legal rules pertaining to landlord-tenant rights and responsibilities. For example, who bears the liability when someone is injured on the premises?

Livestock leases

The same principles apply to livestock leases. Livestock leases are less common but do provide an avenue for building a herd or getting established in the business. Leasing can also be a means of accumulating an efficient-sized livestock operation to improve income potential.

Conclusions

When starting a new lease or renegotiating an existing one, a careful review is desirable. Parties to a farm lease should carefully assess the contributions made and relate them to the lease rate, whether the lease is cash or share. The lease should be written and include all of the details considered important. It is desirable to have the lease reviewed or written by an attorney. A well-written lease is good insurance against problems that may arise.

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