

Managing risk in and through agricultural land leases

Alan Schroeder

The 1992 Census of Agriculture reported that part-owners–operators with a mixture of owned and leased property–controlled more than 55 percent of all agricultural lands in the United States. This number continues to grow, despite complaints from some landlords about poorly maintained buildings and fields and tenants’ criticisms about nosy landlords and arbitrary lease terms. If we could get landlords and tenants together and ask them why leasing is so important and what might be done in their lease arrangements to address alleged abuses, what would they say?

Renting agricultural lands is a useful tool for both tenants and landlords. Leasing agricultural land frees up cash for other purposes, and it allows tenants to share management, price, and weather risks with their landlords. Public land rental may be the only source of additional ground in western states for some tenants. Landlords find that lease payments can provide a steady income stream after retirement. Rental arrangements permit parents to lend managerial and other assistance to their children. Share leasing also allows landlords to take advantage of the federal tax code and reduce income tax liability while building up their social security base.

Drafting agricultural leases to avoid misunderstandings

Many landlord-tenant conflicts are caused by misunderstandings regarding each other’s rights and duties under the lease. To avoid such misunderstandings, parties should address some basic who, what, when, where, and how questions in their negotiations.

The who question can be addressed by identifying all parties to the lease. If subletting or assigning to third parties is not desired, the lease should clearly say so.

The when part of the agreement should clearly state the rental period, manner of renewal, and any notice required to terminate the agreement. Many agricultural leases are periodic leases, which means the agreement is automatically renewed each year unless one of the parties gives notice otherwise. When farm leases are unclear, courts normally assume they are periodic leases. Under the common law of most states, tenants and landlords must give at least 60 days notice to terminate yearlong periodic leases.

Leases that terminate at the end of a stated period are fixed-term leases. Normally, no notice is required to end these leases, though some states—Iowa, for example—have modified this rule. The common law in some states converts fixed term leases into one year, periodic leases (thereby requiring notice to terminate) if the tenant remains on the property after the lease ends, and the landlord accepts rent for the subsequent period. Wyoming statutes require the parties agree in writing before a fixed term lease can be converted into a periodic one.

Written leases should include a legal description of the property, so there is no question about the where of the lease. Agricultural leases should identify all other property—land, buildings, fixtures, equipment, water rights, grazing permits, etc.—included. Doing this spells out what the lease covers.

During negotiations the parties should carefully consider how the property will be managed, how expenses will be shared, and how rent will be paid. Answers to marketing and storage questions may be particularly important under livestock and crop share arrangements.

Here is a brief list of possible management topics to be addressed in your lease:

- Crop(s) to be planted
- Livestock to be raised
- Agricultural and conservation management practices to be used
- Other nonagricultural activities (e.g. businesses) permitted
- Maintenance (e.g. buildings and other permanent improvements) to be performed
- Landlord's right to enter property

- Permanent improvements tenants may/must make
- Treatment of noxious weeds
- Each party's obligations regarding expenses, materials, and management
- Each party's obligations regarding property taxes, special assessments, water charges, and other governmental obligations
- Each party's rights and duties regarding government programs
- Cash rent terms (e.g. one payment or installments, when payment(s) is due)
- Share rent term (e.g. quantity and quality, timing of distribution, storage costs)

Choosing between a cash or share lease

The best form of payment depends upon each party's goals and preferences toward risk.

Fixed cash leases normally involve less (price and yield) risk and management and marketing responsibilities for landlords but do not permit them to take advantage of any price or yield increases that occur.

Share arrangements permit or require greater landlord involvement in management and marketing. This may be a plus or minus, depending upon the parties' goals and ability to work together. Share arrangements also permit landlords to plan crop and livestock sales to lower their income tax liability. Payments received under share arrangements are typically subject to self-employment taxes.

How can parties establish a fair rental amount

A bulletin by the North Central Regional Extension Committee, *Irrigation Crop Share and Cash Rental Arrangements for Your Farm*, suggests three bases for landlords to use when determining a fair cash rent. They are the prevailing rates in the area, the landlord's desired return on his or her investment, and a fixed payment tied to what the landlord would otherwise receive—on average—under a net share arrangement.

Many farmers and ranchers rely on customary rates in fixing their share rents. Customary rates, however, may not reflect current management practices. The North Central Regional

Committee outlines five principles for sharing expenses and returns:

- Variable expenses that are yield-increasing should be shared in the same percentage as the crop share
- As new technologies are adopted, share arrangements need to be adjusted to reflect their impact upon costs and returns
- Both parties should share in total returns in the same proportion as they contribute resources
- Tenants and/or landlords should be compensated at the termination of the lease for the unexhausted portion of long-term investments
- Communications must be maintained between landlord and tenants

What happens when a dispute or a breach of the lease occurs

Good leases establish procedures to handle certain contingencies and disputes. For example, a lease might state that the tenant will be reimbursed a long-term investment, if the lease is terminated prematurely or modify certain duties in case of drought or technological or market changes. It might grant the landlord a lien on the crops until rent is paid and provide for specific remedies (e.g., specified damages and termination of the lease) if the terms are breached. Many leases include arbitration clauses, thereby providing for quick resolution of managing and marketing conflicts.

What other risks should be addressed in drafting an agricultural lease

We only briefly touched on the tax implications of leasing arrangements. Parties should also address legal liability exposures leases create—is the landlord liable for any of the tenants' actions and what continuing liability does the landlord have for injuries suffered on the rented property? To avoid the first problem, the agreement should clearly state that a lease rather than a partnership is being created. Landlords also should avoid any actions that might lead third parties to believe tenants are acting as their agents. Regarding the second problem, landlords should carefully inspect and repair the property before turning it over to tenants. Landlords also should also insist that tenants purchase liability insurance and include them as co-insureds.

Should agricultural lease arrangements be in writing

A written lease clarifies each party's rights and responsibilities. Over time memories fade. Written leases may be particularly important when third parties—in-laws, real estate purchasers, or creditors—become involved. Leases for a year or more traditionally must be in writing to be enforceable by courts.

Leasing is a team effort

Consulting with an attorney is the best strategy in drafting agricultural leases—particularly if long term leases, buy-sell arrangements, leases with life estate holders, or other complexities are involved. Many producers still rely on pre-printed forms in drafting their leases. Form leases are like one-size-fits-all bathing suits; they may cover too little or too much—depending upon the subject—and look out when they get a little worn.

Working with your legal, financial, marketing, and management professionals ensures your leasing arrangement will fit your needs. Additional information on agricultural leases is available at most county cooperative extension offices and on the Kansas State University Research and Extension Home Page: <http://www.oznet.ksu.edu/library/PUB/LIBRARY/agecon/agecpub.htm>

Alan Schroeder is an Associate Professor and the Agriculture and Natural Resource Law Specialist in the Department of Agricultural and Applied Economics at the University of Wyoming.