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College of Agricultural, Food,
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Farm Leases

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Leases play an important role in many farming operations. Many farm operators do not own the land they farm or they own only a portion of it. The number of farm operators who lease land continues to rise. Yet many farm landlords and tenants are unfamiliar with the legal aspects of the landlord/tenant relationship. In addition, leasing farm machinery and equipment has become commonplace. Increasingly, anything one can borrow to acquire, one can also lease.

Types of Real Property Leases

Agricultural leases traditionally are divided into two general categories: the cash lease and the crop share lease. The cash lease involves cash payment of a specified sum or an amount determined by a formula in exchange for the use of farmland. Under a typical crop share lease, however, the landlord provides part of the equipment and supplies such as seed, fertilizer, and chemicals. In exchange, the landlord receives a share of the crops as rent. The rent share usually ranges from one-third to one-half, depending on local custom and the farmer's and landlord's contributions toward production costs.

The landowner and farmer are free to establish the relationship that will govern their operation. The lease agreement between the parties is critical in determining what rights and duties exist between landlords and tenants. The following elements are necessary to create a landlord/tenant relationship:

1. valid contract;
2. provisions for payment for the use of the land;
3. The transfer of substantial rights to the tenant;
4. Possession and control of the property by the tenant; and
5. A reversionary interest in the property in favor of the landlord at the conclusion of the term of the lease.

Oral Leases

Traditionally, written farm leases have been the exception rather than the rule. One reason may be an

assumption that requiring a written lease appears as if the parties do not trust each other. It is, however, highly desirable to put the terms of any rental agreement in writing. Advantages of a written agreement include: a detailed statement of the agreement which ensures better understanding by both parties; a reminder of the terms originally agreed upon; and a valuable guide for heirs if either the tenant or the landowner dies.

Under Minnesota law, any lease extending for a period longer than one year is void unless the contract is in writing and signed by the party by whom the lease is to be made. This law, known as the Statute of Frauds, is in force in every state and applies only to leases that are wholly oral. The writing required to remove a lease from the application of the Statute of Frauds does not have to be a detailed contract. A memorandum or note is sufficient if it has been signed by a party or for that party.

An exception to the Statute of Frauds has been recognized by most courts, however. Even if a lease is unenforceable because of the Statute of Frauds, it may be enforced if one party relies on the contract and substantially performs under the lease. The action required on the part of the tenant to constitute such substantial performance must be determined on a case by case basis. A second exception to the Statute of Frauds has been recognized by courts in cases in which one of the parties has misrepresented or otherwise taken advantage of the other. The Statute of Frauds cannot be used to accomplish a fraud.

Classification of Leases

There are two classifications of leases: periodic tenancy and tenancy for years. Tenancy from year to year is a periodic tenancy and is very common in Minnesota. The important characteristic of periodic tenancy is that it can last indefinitely. In other words, it renews itself automatically unless adequate notice to terminate the tenancy is given. Typically year-to-year tenancy is created by an oral agreement, however, it can be and often is outlined in a written lease. Such leases are terminated when one party gives the other notice of termination as required in the written agreement. Without a written agreement, a year-to-year tenancy can be terminated under Minnesota law if three months' notice in writing is given by one party to the other party. If, however, the tenant fails to pay the rent due under a lease, only 14 days written notice is required by the landlord to the tenant.

Tenancy for years is a tenancy measured by a period of time, lasting for an amount of time specified in the lease. Unless the lease provides otherwise, no notice is necessary to terminate such a tenancy. The tenant's right of possession automatically terminates at the end of this period.

Although agricultural tenancy begins on March 1 in many farm states, no law in Minnesota determines when an agricultural tenancy begins. The Minnesota Supreme Court has determined, however, that farm leases do not terminate in the summer months while the crops are still unharvested. Rather, such tenancies terminate in the spring or in the fall. When a year-to-year tenancy terminates is important because the date of termination determines when the written notice must be given to legally terminate the tenancy.

Rights and Duties of Landlord and Tenant

Unless a lease provides otherwise, it is presumed that a tenant will conduct the farming business according to prevailing customs or usages of the community. He or she is not required to leave the land in the same condition it was in when he or she took possession, however. The tenant has the right to determine the cropping system and rotation to be applied on the leased property. He or she must not, however, commit "waste." What constitutes waste must be determined on a case by case basis, but in

general, the tenant must not allow the real estate to be permanently or substantially damaged. For example, the tenant may not remove valuable topsoil from the premises. Most courts, however, have held in favor of tenants who have used poor conservation practices such as permitting land to grow up in weeds and go uncultivated. As a result, it is in a landlord's best interest to include specific provisions in the lease detailing expectations of the tenant as part of the normal course of husbandry.

Of increasing importance are concerns regarding ownership of growing crops. It is clear that in cases of cash rent lease, the crops belong to the tenant. In the case of a crop share lease, however, the answer is not so clear. Most states have held that the tenant retains title to the crops until they are harvested and divided. Other courts, including Minnesota courts, have held that a landlord's interest in the crop attaches once the crop has been planted. As a result, the landlord may sell his share of the crops prior to harvest.

Minnesota law provides special protection for agricultural landlords by giving them a lien for rent upon crops grown or growing on the leased property and their proceeds. To protect this lien, a landlord must file a lien statement in the county recorder's office within 30 days after the crops are planted. A landlord's lien which is perfected by filing a lien statement has priority over all other liens or security interests in the crops grown or produced on the leased property. A possible limitation on the use of such a statutory landlord's lien is presented by the Bankruptcy Code. Even though such a lien is perfected, it may be set aside in a later bankruptcy proceeding. As a result, it may be more advantageous for an agricultural landlord to include provisions creating a security interest under the Uniform Commercial Code (UCC) in any such lease. However, any such security interest will not obtain the priority granted the landlord by the Minnesota lien law. To ensure that his security interest will be the first lien against the crops grown on his farm, the landlord should require each and every other party who claims an interest in his tenant's crops to agree to subordinate their claims. The requirements for creating a security interest under the UCC are discussed in another fact sheet in this series, [Security Interests in Personal Property](#).

Personal Property Leases

Besides leasing land, today's farm operator may lease items of personal property such as silos, livestock facilities, and machinery. Leasing provides an alternative to acquiring the use of assets through ownership. Under many leases, the owner of the property recovers the full investment in the property over a specified term. In fact, in many cases, the lessor under such leases may be a financing company that has purchased the leased property from the manufacturer for the sole purpose of leasing it to a particular farm operator. In such a case the lease is simply a financing device that creates an obligation not unlike that imposed by formal indebtedness. The legal relationships may be drastically altered by virtue of the lease, however.

If the leased property proves to be defective, it may be much more difficult to enforce any warranty claims against the lessor or dealer. The UCC provisions dealing with implied warranties do not, in the case of a bona fide lease, apply to defective property. Besides warranty difficulties, the lease may provide that in the event of default, the lessee not only loses possession of the leased property and recovers none of the payments made to date, but also is held liable for the balance of the lease payments. Finally, the lease may provide that in the event of default, the lessor may repossess the property without notice or resort to the courts. In short, the leasing of personal property may prove to be a risky business unless the farm operator understands the nature of the relationship with the leasing company.

In addressing these issues, many courts have held that arrangements bearing the lease label are, in fact, disguised security interests or sales contracts. The question of whether an arrangement is a true lease or a sales contract must be determined by the facts and circumstances of each case. As a general rule,

however, inclusion of a provision in the lease that allows the lessee to purchase the property at the termination of the lease for little or no additional consideration will be construed by a court as evidence that the arrangement is, in fact, a sales arrangement. If found to be a sales contract, the provisions of the UCC with respect to security interests and termination of security interests may apply in the event of default. In addition, the provisions of the UCC regarding warranties may be triggered.

Conclusion

Leases have become more common in the financing of farming operations. Although the terms of such arrangements are often critically important, agricultural real estate leases traditionally have been handled informally. Given their importance, however, the terms of such leases should be carefully considered and addressed in a written agreement.

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