

DEVELOPING A LEASE FOR THE FARM

Editor's note: A review of published literature in the Southeast found little on developing lease agreements, so we have turned to other sources from regions with issues similar to those we face here in the Southeast. The piece below draws heavily from several sources: *A Lease Agreements Guide for Landowners and Farmers*, from the University of Vermont, written by Deb Heleba, David Major and Bill Snow, and *Managing Landlord-Tenant Relationships: A Strategic Perspective*, published by Ohio State University and authored by LeeAnn E. Moss and Bernie Erven. Other observations are those of the author based on experience working with traditional and non-traditional leasing arrangements.

If you want to keep your land in farming, you will need someone to farm it. For most landowners, that will mean developing an agreement with a farmer for how the land will be farmed.

Traditionally in the Southeast, landlord and tenant arrangements have been based on family or neighbor relationships, and rarely in writing. In areas where farmers utilize fairly large tracts of land, rotating a limited number of commodity crops through the years, land is changing hands between generations which will likely change the way farmers and landowners have been doing business together. As more and more parents pass on, adult children inheriting rights in farms may want to hold on to them but are seeking a more formalized agreement with the farmer who has been tending the land. Closer to urban areas, some landowners who wish to hold on to the land for the foreseeable future may find opportunity in working with a farmer whose farming practices require a stronger tenure relationship than the traditional handshake. Even within families, a successor must often become a tenant before he or she becomes an owner of the land.

Guidelines for Landowners

There are several issues to consider before you enter into an agreement to create a successful working relationship with a farmer. For those landowners without experience renting or leasing land to a farmer, this narrative is meant to provide you with some of the basics involved with putting together an effective

farmland lease agreement that will serve your needs. For those with experience, changes in agriculture practices and markets will likely bring up new issues you must address.

First, as emphasized in the previous section, you need to take stock of your land and take a look at what you have to offer and your goals for the property. For landowners, determining the amount and quality of land you have available is an obvious place to start. Keep in mind that not all land is created equal, particularly in the Southeast. Land usually slopes in one or more directions, it can be rolling and hard to see from all points. The key is knowing exactly how much land you have to work with.

Poor land, very small parcels, or land with poor accessibility and/or obstructions may not even be worth considering, as these may be too difficult to farm. Parcels too small to accommodate ever larger planting and harvesting equipment, yet remote from direct market opportunities may not be marketable for farming use. However, if the land is fertile, accessible, and of a decent size, you may find farmers interested in farming it. Indeed, in some areas you may be blessed with a healthy competition for leasing your land.

Landowners can turn to several sources to “discover” their land if indeed they do not already have a recent relationship with it. Many will have recreational relationships with their parents’ land (e.g. hunting, fishing or horseback riding), but may be less familiar with how it is managed for income production through farming or forestry. Landowners can inquire for their records through the county Farm Service Agency (FSA) office, which may include crop production history, aerial photos, NRCS program participation. Landowners can also request assistance from their county Cooperative Extension service who may have a working knowledge of how their particular parcel has been managed over the years, or the county Soil & Water Conservation District office, who might be available to walk the land and point out important soil and hydrological features, as well as certain restrictions pertaining to environmentally sensitive tracts of land.

Probably your best *first* person to help educate you

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about your land is the farmer who has farmed it. In many cases, this will help lay the foundation for a continuing, if more formalized, legal relationship.

As emphasized in Section One of this workbook, a clear statement of your values, goals and needs - as well as your desired role in decision-making - for your farm will form the foundation of your work on agreement with someone who will farm it, whether that person is related to you by blood or not. Below are a few points to consider from your side of the agreement:

1. **The written lease:** Lease agreements for farmland or other real property assets should be in writing. The limited advantage of an oral, annual agreement is that the agreement ends at the close of the season. However, such arrangements create instability for both landowners and farmers. For landowners who will be providing more than just passive use of their land, such as providing lime, providing cash for custom tillage work from a neighboring farmer, or other inputs, you must protect your own liability by ensuring that the relationship with your tenant cannot be construed as a legal business partnership. Furthermore, you may wish to limit your own liability from practices of the farmer that may give rise to liability, such as misapplication of chemicals, environmental degradation, etc., and be sure that you are indemnified for any liabilities you may incur due to these actions.

2. **Ask questions:** Increase your understanding of how land is used. Understand that the language used by the farmer is that of his or her profession, terms that have everyday meaning to him or her will be unfamiliar to you. Do not be afraid that asking even a basic question will somehow expose ignorance and put you at a disadvantage in your discussions about a rental agreement.

3. **Be flexible (and clear) on your role:** In some cases, personal values that the land be farmed and well-taken care of will drive a landowner's desire to rent the land to a farmer. For those landowners particularly enthusiastic about emerging local food systems and environmental stewardship, you should be prepared that a farmer may have challenges with sharing daily operational decisions if you have no farming experience to offer. It may be best to consider your investment of land into this equation as your contribution, and defer to the skills of the producer in managing that contribution (again,

subject to your goals, etc.). Even in share-lease situations, understand that a lease is not a partnership and should not give you the go ahead to weigh in on day to day decisions (unless you both have so agreed), this is a breeding ground for frustration and disagreement.

4. **Stay informed of market conditions:** This applies to both the market for land rents, as well as what is going on with either commodity prices or other product market conditions. Depending on the flexibility in your lease, or how you otherwise handle changed agricultural market conditions that affect the viability of your farmer tenant, you will need to be prepared to respond to the situation where the current rental rate agreement is jeopardizing the farmer's operational abilities.

5. **Schedule annual meetings:** Your ownership of your property should be considered a business, so you should have business-like meetings with your farm tenant to overview the season that has ended, issues that you want to bring up about the condition of the land, important changes in your life that will have an impact on the next year, particularly as they relate to your already stated goals for the farm. If there was something you saw that you were not happy with when you visited the farm, ask about it.

6. **Weigh new offers rationally:** Smooth working relationships between farmers and landowners often span generations. A stable farm tenant, when you consider your management options for the land, should be considered an asset. Be reasonable when offered a higher rental payment by a new and untested tenant, and allow your current tenant to address any issues where their work may appear deficient compared to what someone new is offering. In some areas, competition for land can be fierce, and though you may strive for a higher monetary return from the land, a revolving door of tenants may have its costs as well. Landowners should consider that, if not for this farmer and their stewardship of the land and relationship with their parents (which may have extended beyond mere payment of annual rent), they might have otherwise found the land in poor condition, eroded or grown up in "volunteers" (unintentional trees of no commercial value).

General Guidelines for Tenants

For farmers, take a look at what *you* have to offer. Be clear about what type of farming you want to

do on the land. You should be prepared to answer basic farming questions. Landowners - especially new purchasers or inheritors - may be extremely inquisitive about your farming practices simply because they may not be familiar with agriculture. Indeed, if you have been farming the land for a time, you may have had a fairly straightforward verbal rental arrangement with an elderly couple, perhaps a retired farmer, and then his widow, now only to find that those who have inherited the land are raising new questions about production practices and rent. Farmers may consider that the inquiry may bring changes to how they have operated the land, and should be prepared to offer a basic and open education in farming practices. Remember that a little education will go a long way in creating a satisfying longer-term relationship with a supportive landowner.

The end goal for most farmers is a delicate combination of stability, affordability and flexibility. Many of the suggestions below for farmers are soft approaches, but experience has shown that solid relationships can sometimes transcend economic and competitive issues normally associated with how much rent you can pay for use of the property.

The following points should be included in the farmer/tenant's landholding strategy:

1. **Ask for a written lease:** Oral leases - long a tradition in Southeastern agriculture - can provide opportunities for disagreement, even based on innocent misunderstandings, which once crops are planted become more difficult to resolve. Further, your investments in the land - such as a three-year lime application - are not protected under an annual oral lease, only your right to harvest planted crops is protected by state statute.

Clear language will resolve many issues, but a lease can also provide a dispute resolution scheme for when disagreements occur due to actions of either party during the lease. Further, should the land change hands during the term of the lease - due to death of the landlord or sale or gift of the property - a written lease offers protection to the farmer. Southeastern states require leases of certain length to be recorded with the county Register of Deeds in order to warn purchasers of the land that there is a tenant with farming rights on the land. For example, Virginia requires leases in excess of five years to be recorded.

(Note: in order to protect the confidentiality of elements of the agreement, such as the rental rate, a Memorandum of Lease can be recorded to satisfy this requirement).

2. **Provide a resume:** When approaching landlords that you have not worked with before, you should provide an overview of your farming operation and experience, including philosophies on production practices, business objectives, education, tillage practices, equipment use, financial strength and other land tenure relationships. Some prospective landlords might not agree with your philosophies and practices, so it is good to know earlier as this will only cause problems in the arrangement as time moves forward, causing stress on the success of the operation.

3. **Agree on a cropping plan:** Open dialogue early on a cropping plan, which should include input and field operation specifics. For new and/or younger farmers interested in smaller-scale, high intensity production for direct market, be prepared to have your business plan ready for review. You must build this landowner's confidence in your ability to continue a business on their land.

4. **Keep communication open:** Providing regular updates on crop conditions, markets, and planned activities such as cropping and harvesting, conservation implementation (if authorized), general cattle rotations, etc. will help visiting landowners (who will sometimes visit the property in the farmer's absence) understand changes they are seeing on their property. A report can give you a baseline to refer to when asked later about something they have seen happening on their property. Consider including cost information in these communications, as this will help the landowner understand certain issues that may become relevant regarding rent amounts, landowner contributions (if applicable), etc. When on-farm problems occur, notify the landowner.

5. **Educate the landowner:** As noted above, just by virtue of time and rural demographic changes, more farmers will be working with more non-farmer and absentee landowners. Ohio State's Moss and Erven suggest regular mailings of farm journal articles and even developing a website which can both educate the landowners and their potential heirs while demonstrating the farmer's interest in their knowledge. In some cases, particularly

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nearer to urban direct markets, it may be helpful to educate the landowner in how their land is part of a larger farming and food system, one in which they are a key player. Some inheritors of land, themselves urban dwellers with an interest in “local foods,” express the interest that their land be farmed “organically” without understanding the technical nature of the term. Your ability to provide them with a bigger picture, while helping them understand the “technical” nature of organic production may serve you well.

6. Improve the farm: Experienced farmers often state a goal of leaving a farm in better shape than when they got it. The farm’s appearance - maintenance of roadways, fences, clearing brush around old houses and structures - is usually the first impression other landowners get of the farmer’s reputation in the neighborhood, which will correlate directly to the perception formed on that farmer’s abilities and value as a tenant. Consider this a visual resume of your abilities.

7. Pay attention to the current owner: Acknowledging life events - holidays, birthdays, the passing of close relatives - of landlords improves a farm tenants’ longer term access to the ground. When receiving honors for conservation or other practices, it sends a strong message - if the venue is right - to also invite and recognize the landowners you work with.

8. Don’t forget about the future owners: Land is going to change hands, in many cases sooner rather than later. This workbook encourages owners of land to engage their families (i.e., children or other potential heirs) if planning needs to be done for the future of the land. Farmers should look for ways to include the “next generation” owners where possible in their passive communications with the landowner while being sensitive to established lines of communication within the family.

Types of Leases

Cash Rent

Most rental arrangements are for a set price per acre for a set time, normally per year. The farmer pays the landowner the total of the rate per acre multiplied by the number of acres farmed. Under this arrangement the tenant bears most of the costs - and thus most of the risks - of preparing the land for production and growing and harvesting the crop. Thus, the tenant still

owes rent in the event of crop or market failure. Some cash leases provide for an amount paid tied to the price of the crop, actual yields, or a combination of both, and can offer a lower base rent to protect the farmer in bad years while rewarding the landowner in better years.

Crop Share

A crop share risk allocates risk between landowner and tenant, splitting the costs and the proceeds of production according to agreement. Crop (or livestock) share leases allow landowners in strong financial position to contribute to costs of production, which can be of great help to a newer farmer shorter on early season operating capital. Care must be taken to distinguish such an arrangement from a legal partnership. Share leases can also give the landowner a specified share of the crop (which the farmer can buy for a set price or the landowner can sell on the open market), so when the farmer does well the landowner does well. (See sidebar *Comparison of Cash Rent and Crop Share Leases* next page)

Basic Elements of an Agreement

Below are the basic elements of a lease agreement. As alluded to earlier in this narrative, there are many variations of the themes below.

1. Identity of the parties. The lease must be signed by the actual owner(s) of the property or those with proper authority to bind the property to the terms of the lease. Keep in mind that property that has been inherited may have more than one owner. If property is held in a trust, the trustee must sign. If land is held in a limited liability company, the person with management authority must sign. Failure to secure the signatures of the proper owners leaves the lease vulnerable to being voided by owners who did not consent to the agreement.

2. Description of property. The property description in the agreement identifies the land both parties intend to be farmed. The lease should identify the land area, buildings, equipment and animals (if applicable). Land can be described by inserting appendices to the agreement (properly referenced in the document) that contain either the deed description or a portion thereof, and/or aerial photos of the property from FSA or county Geographic Information System (GIS) websites, with fields and access marked on the photograph. Access should clearly be set out, especially where access crosses other land or to structures not in the leased premises.

3. **Term of lease.** The lease should specify when it begins and when it ends. Verbal rental agreements are normally protected by state statute for the term of one year, up through harvesting of crops on the land. In coming to an agreement, the farmer should consider the amount of time necessary to recoup his or her investments in the land. Multi-year leases can offer a set term that binds the property for that period, with a renewal clause that should be clear on how renewal takes place or notice of termination is

given (i.e., time period and manner). It is reasonable to both parties to allow a minimum six-month period to announce an intent not to renew the lease.

4. **Amount and terms of rent.** For a cash rent lease, the amount of rent is normally paid in one payment by a particular date, traditionally near the end of harvest when the farmer has cash from the sale of crops. For more diversified operations with earlier market harvests, the parties can agree

COMPARISON OF CASH RENT AND CROP SHARE LEASES

(from *Improving Your Farm Lease Contract*, Iowa State University)

Cash Lease

Advantages of a straight cash lease are:

- The lease is simple with relatively few chances for misunderstanding.
- The owner is relieved of making day-to-day operating decisions.
- The owner has very little financial risk.
- The tenant has maximum freedom in planning and developing the cropping and livestock programs.
- The tenant has fewer records to keep.

Disadvantages and potential problems of the straight cash lease are:

- A fair cash rental rate may have to be renegotiated each year.
- Cash rents are likely to be too low in times of rising prices and increasing yields, and too high in times of low prices or low yields.
- Tenants are required to supply more operating capital.
- Tenants bear all the risk of price and yield variability.

Crop-share Lease

The advantages of a crop-share lease are:

- Crop risks associated with price and yield variations are shared equally.
- The owner is more involved in operating decisions and marketing the crop during the year.
- Both parties share the benefits from adoption of yield-increasing technology, or unexpected high yields or prices.
- A second USDA payment limit is created.

Disadvantages or potential problem areas of a crop-share lease include:

- The landlord and tenant must determine how production expenses are shared.
- Adjustments for sharing costs for storage and drying facilities, herbicides that reduce field work, or fertilizer and pesticide application may have to be made.
- The cropping plan to be followed and whether or not the farm participates in government programs must be agreed on.
- Added cash rent for buildings and facilities may have to be negotiated.
- If the owner's and tenant's crops are stored in a common bin, marketing decisions have to be made jointly.
- The landowner may be considered a material participant, and farm income will be subject to self employment taxation.

DETERMINING A FAIR RENT

In a lease agreement, determining a fair price is often the most important factor for both parties, yet it can be difficult to establish in many farming situations. Location, soil quality, the forces of supply and demand, commodity and direct-market prices, as well as your personal goals for the land all play a part. For higher-grossing, larger acreage operations, establishing a rental rate can be more straightforward where there is a history (and reasonable forecast) of cost and price information.

Many landowners have traditionally charged just enough to cover the taxes on the land. Others don't charge, especially when the trade-off is keeping a pasture mowed (in exchange for the hay the farmer takes). Most agreements are set up on a per acre basis, where a rate per acre times total acreage used becomes the annual payment. Below are some considerations for setting the rental rate:

1. **Market rental rates.** The only practical way to determine real market rates is to ask around. As best as possible, talk with local farmers to get a feel for what they are paying for land. Call the cooperative extension office for the county: if your farm is in pasture, ask to speak with the livestock agent; if your farm is in row or field crops, ask to speak with the agent who advises farmers on those crops. If you are an "absentee landowner" (i.e., you do not currently live in that community), be sensitive to the fact that you are inquiring about issues that may economically impact the businesses of farmers that local cooperative extension agents and soil & water conservationists have worked with for years. Remember that land and the infrastructure on it can vary greatly, so what others are charging may not be appropriate for a particular farm. Make sure you compare your rate to rates for land of comparable quality, based on actual yields or productivity indices.¹

2. **USDA Farm Service Agency (FSA) county average rental rate.** The USDA Agriculture Statistics Service surveys farmers and landowners to compile annual reports of average rents for high,

medium and low productivity crop and pasture land. Note: The results of these surveys, while considered reliable, may not accurately describe conditions in certain parts of a county.

3. **Cost of land to the landowner.** Many landowners are content to simply cover their costs of "carrying" the land. These costs typically are the sum of depreciation (on certain structures), insurance, repairs, taxes, and interest. Most agricultural and horticultural land (and a fair amount of forested land) is enrolled in the state's "land use assessment" tax program whereby qualifying land is assessed at a property tax rate lower than its highest use. The program normally requires that farm and horticulture land produce a set annual gross income, which can be quite low, but nonetheless requires someone to farm the land and show income receipts.

4. **Costs of production (tenant's residual).** Another approach is to calculate how much income the tenant has available for rent payments after subtracting all the tenant's costs associated with producing the crop on the land. This approach will require yield estimates, projected market prices, and perhaps government payments, to determine an income picture. Next, calculate the operating expenses for the year. Next, subtract the tenant's cost of machinery and equipment ownership, which includes costs such as depreciation, a return on investment, insurance, and machinery housing. Finally, a figure should be calculated and subtracted for the tenant's labor and management. The remaining amount is available for the payment of cash rent. Without the willing participation of a prospective and experienced farm tenant, this approach will be a challenge for most landowners.

¹ <http://www.extension.iastate.edu/agdm/wholefarm/html/c2-20.html>

to an installment schedule for preparation of the land, spring crop harvest and fall crop harvest. Determining a fair rate is often a challenge, but there are several methods to consider (see sidebar *Determining a Fair Rent, next page*).

5. Allowable and prohibited uses. The lease normally limits use to agricultural production. Some landowners may want to specify prohibited uses, such as chemical application. Landowners should consider the practicalities of limiting certain activities that would otherwise reduce the productivity of the operation. Remember that all prohibited uses can be qualified by written consent if the lease so declares. Below is a partial list of issues to address:

- The lease should address protection of conservation program features, including buffers and grass waterways.
- State and federal regulations and laws should be incorporated by reference. If the landowner will allow application of chemicals (pesticides, herbicides, etc.) to be applied to the land (indeed essential to many production areas), the lease should state that only USDA approved chemicals be used and applied according to federal and state regulations. Further, the lease can restrict application of chemicals that have a residual life beyond the term of the lease.
- If the landowner intends to reserve mineral rights to the property, extraction activities such as removal of sand or gravel should also be expressly prohibited.
- It is prudent for the landowner to require the property to be left in the same condition as when the lease began, and include a redress for documented damages to the property (a photographic baseline can be made at the beginning of the lease). Though a prudent would-be tenant will have inspected the land, the soils and water availability before choosing to farm that property, the landowner should make clear that he or she offers no warranty as to the production capabilities of the land.
- Any land clearing should be discussed beforehand, and burning should be reserved to consent of the landowner upon showing of proper permits if applicable to the area.

6. Repairs and maintenance and improvement costs. Maintenance of property should be allocated between the parties, including responsibility for routine repairs and those caused by extreme weather events or fire. Be sure to list items such as fencing, gates, wells and pumps, etc. See *Worksheet 3.4: Repairs and Maintenance Checklist*.

7. Rights and obligations of both parties. Issues that can be addressed can include prohibitions on the right to sublease, payment of utilities, right of entry and inspection by landowner. A statement that the lease is not a partnership between landowner and tenant should be included, as well as a statement binding the heirs and assigns (i.e., subsequent purchasers) to the terms of the lease agreement. The lease should also contain a clear indemnity clause, requiring parties to pay for liability attributed to one party for the actions of another. It is common sense to require that both parties keep insurance policies at a designated level for just such a purpose.

8. Termination of the lease and default. Default means that one of the parties has not lived up to the obligations attributed to them in the lease. Numerous events can trigger default: failure to pay rent, failure to abide by any use prohibitions, maintain liability insurance, comply with laws and regulations, bankruptcy, etc. Default does not necessarily trigger termination, but should trigger a process for recognizing and curing the default if possible. If the default cannot be cured, a process should be spelled out for repossession of the property by the landowner, including reserved rights to crops by the farmer. Disagreements should be subject to a clear dispute resolution process.

As a practical matter, a lease is only as good as the parties' willingness to enforce it in court. The more thorough and open the agreement process, the less likely a disagreement will occur in the first place. Although it is likely impossible to build a lease agreement that will provide for all contingencies that might occur, both parties should try to anticipate foreseeable occurrences and identify the procedure for what the parties do should something unforeseen occur. Because both landowner and farmer benefit from a written lease agreement, both should take care in developing an agreement that supports each other's goals.