FREE LUNCH WEBINAR SERIES: FARMLAND LEASING

MANAGE
Farm. Finance. Family.
UNIVERSITY OF TENNESSEE EXTENSION

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UTIA INSTITUTE OF AGRICULTURE THE UNIVERSITY OF TENNESSEE
Real. Life. Solutions.

March 18: Types and Terms of Farmland Leasing

March 25: How to Figure out a Fair Rental Rate?

April 1: Legal Considerations

Poll

- Are you a **L**andlord or **T**enant?

Overview

- What are the different types of farmland leases and which one is right for me?
- Do I need a written lease or is an oral lease sufficient?
- What should my lease say?

Types of Farmland Leases

- Cash Leases
  - Fixed
  - Flexible
- Crop or Livestock Share Leases
- Hybrid Leases

Cash Leases

- Fixed cash lease – rent is predetermined or fixed by the lease agreement
  - Tenant makes production and marketing decisions
  - Tenant bears all of production and price risk
- Flexible cash lease – rent is tied to yield or gain, crop or livestock prices, and/or input costs
  - Tenant makes most, if not all, production and marketing decisions
  - Landowner and tenant share production and/or price risk

Example

(C) <u>OPTION "C"</u>: An annual fixed rate or amount is paid by LESSEE to LESSOR on or before specified date(s). (For example, LESSEE pays LESSOR $150 per acre of bearing subject crop, on or before January 10 immediately following that crop year.)

Crop or Livestock Share Leases

- Rent is a specified share of the crop or livestock produced
- Landowner and tenant share
  - Production and marketing decisions
  - Expenses associated with operation
  - Production and price risk

Example

(B) OPTION "B": If chosen, subject crop income is allocated by a defined percentage of each payment received to LESSOR and to LESSEE. (For example, LESSEE retains 85% of crop income subject to lease; LESSOR receives 15% of each subject payment. An alternative frequently allows LESSEE TO "hold" LESSOR'S share until a specified date.)

b. Records of all expenses and yields will be kept by the tenant and shall be available to the landowner upon request.

c. U.S.D.A. farm program payments will be shared in the following manner: ____________________
____
____

Hybrid Leases

- Some combination of the above
- Examples (greenhouse)
  - Guaranteed lease – rent is predetermined by square footage
  - Minimum cash lease – fixed minimum rent plus a percentage of
    - Crop sales or
    - Gross sales above some amount
- Landowner and Tenant share production and/or price risk

Example

(A) OPTION "A": If chosen, this pricing option is designed to reimburse LESSEE their operating expense attributable to subject crops FIRST. Residual retur thereafter are typically shared between LESSOR and LESSEE.

(For example, LESSEE receives the first 14 cents/lb. or the first $1100.00 per bearing acre of tart cherries; LESSEE and LESSOR then each receive 50% of remaining residual income as it is received. Per acre, per bushel, or per ton may be other pricing units.)

Choosing a Lease Type

- Fixed cash leases
  - Simplest
  - Amount of rent is certain
    - $ per acre or $ per head or animal unit
  - More appropriate for tenants who can bear all of the production and price risk
  - Ensure that party responsible for management and marketing bears all of the production and price risk
  - May not be suitable for landowners and tenants interested in a multiple year lease due to uncertainty over future yields and prices

Choosing a Lease Type

- Flexible cash leases
  - More complex than fixed cash lease
  - Landowner’s income is no longer “certain”
  - Increased recordkeeping and reporting requirements
  - Allows Landowner and Tenant to share in production and/or price risk

Choosing a Lease Type

- Share leases
  - Are more appropriate for tenants who cannot supply all of the operating capital or who might benefit from landowner’s knowledge of the farm and/or management and marketing expertise
  - Increase the potential for friction between landowner and tenant over production and marketing decisions
  - Require more detailed records and coordination to ensure accurate division of production inputs/costs and yields/revenues

Oral vs. Written Leases

- Oral leases for more than a year are not enforceable (*Statute of Frauds*)
- Written leases are recommended

All leases should…

- Provide names and addresses of landowner and tenant
- Provide a reasonably accurate description of the land and/or buildings to be leased
  - Legal description is preferred
  - Address or popular name (“Ben Jones Farm”)
  - Maps can be attached to the lease to identify specific fields if something less than an entire farm is being leased

All leases should…

- Specify rental rate or procedure for calculating the rent
- Designate time and place rent is to be paid
  - Penalties for late payment, if any

All leases should…

- Specify when they start and when they expire
  - Can be (virtually) any length of time
  - Most farm leases are for at least one year, while very few have a term of more than five years
- Be signed and dated by both parties

All pasture leases should…

- Specify a maximum stocking rate
- If water is an issue, Landowner and tenant obligations should be specified

All share leases should…

- Specify the share of production costs that are to be paid by each party
- Impose recordkeeping requirements on one or both parties
  - Typically imposed on tenant as tenant is typically closer to day-to-day farm operations
  - Landowners interested in government program payment support should require tenants to keep and share production records even in a cash lease

Resources

- Free Step-by-Step Lease Building Tool: https://farmlandaccess.org/farm-lease-builder/getting-started/

FARM LEASE BUILDER

USDA United States Department of Agriculture National Agricultural Library

exari

Farm Lease

FARM LEASE BUILDER INSTRUCTIONS

Welcome to the Farm Lease Builder! This tool will take you through a series of lease-related questions. Your answers will be used to create a draft Farm Lease Agreement.Your draft Farm Lease Agreement can be downloaded as a Microsoft Word document and edited by landlords, tenants, and lawyers. The draft is me ucational and informational purposes only.The instructions below will help you navigate the Farm Lease Builder.

UTIA Leasing Resources

https://farmlandlegacy.utk.edu/leasingresources.html

- Publications
  - *Introduction to Farmland Leasing*
  - *Cash Leases*
  - *Crop-Share Leasing*
  - *Pasture Leasing*
  - *Lease Termination*

UT Extension

PB 1816-A

Introduction to Farmland Leasing

This publication provides management information and guidelines for landlords and tenants to follow when negotiating rental agreements for farmland in Tennessee. It is designed to help landlords and tenants structure a rental arrangement suited to their individual circumstances.

More than a quarter of Tennessee's farmers lease land and leased land accounts for more than one-third of Tennessee's farmland. Thus, continued access to leased land is crucial to the successful operation of many of Tennessee's farms. In addition, leasing provides young farmers with access to land and facilitates the transfer of land from transitioning and retiring farmers. In many instances, farmland leases are of the handshake variety. As a result, many leases fail to provide for a wide range of contingencies that could and should be addressed. This failure can lead to unnecessary conflict between landlords and tenants either because they fail to consider and agree on how to address these contingencies or because one or the other misunderstands or misremembers how the contingencies are to be addressed.

What Is a Land Lease?

A land lease is a contractual agreement by which a landowner transfers to a tenant the right to use and possess land and/or other real or personal property for a limited period of time. In exchange for these rights, the tenant agrees to pay the landowner rent in the form of either a cash payment, a share of the crops produced, or the income from livestock sold.

Why Lease Farmland?

All farm operations have different needs, different cash flow patterns and different income streams. Land can be an expensive resource requiring a large capital investment. If the capital is not available or is a limiting constraint, leasing can provide access to land for fixed or variable rental payments. Leasing also provides an alternate method for young or beginning farm families who cannot afford a down payment or who do not have the sufficient income to meet the financing payments required for starting a farm while building equity for a future purchase.

Also, many individuals or institutions that own farmland are looking for someone to farm it to provide a return on their investment as well as maintain its productivity. Many of these landowners are former farm operators who have retired and who wish to retain their investment in the land for security, retirement income and/or sentimental reasons.

Types of Farmland Leases

- **Fixed Cash Lease** — Cash leases involve a fixed cash rental payment that is specified in the lease and, for farmland, is typically paid on an annual basis. In a cash lease, the tenant bears all of the price, yield and production risks and rewards.
- **Flexible Cash Lease** — Flexible cash leases involve variable instead of fixed rental payments. A formula for calculating the flexible rental payment is specified in the lease and is typically based on changes in crop or livestock prices, yields, and/or certain production costs such as fertilizer, seed or pesticides. For example, if a flexible cash lease is based on crop prices and crop prices increase during the lease, the amount of rent due also would increase. Similarly, if crop prices were to decrease, the rent also would decrease. In flexible cash leases, landlords and tenants can share price, yield, and/or production risks and rewards, depending on the nature of the rent calculation.
- **Crop-share Lease** — With a crop-share lease, the rent paid is a share of the crop produced. The most common landlord-tenant share agreements in Tennessee are the 1/3:2/3, 1/4:3/4, and 1/2:1/2 share arrangements (where the first fraction represents the landlord's share and the second fraction represents the tenant's share). For example, in a 1/3:2/3 share arrangement, the landowner would be responsible for 1/3 of the production expenses and would receive 1/3 of the crop, while the tenant would be responsible for 2/3 of the production expenses and would receive 2/3 of the crop. The landlord and tenant can decide to market and sell the crop collectively or individually. They also share expenses and income associated with the crop and, thus, price, yield, and production risks and rewards.

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