Topic II. Classic tenure: Ownership and tenancy options

Learning objectives

1. Explore the range of options under ownership and non-ownership tenure for new farmers.
2. Evaluate options to determine the best fit for an individual scenario.
3. Understand the relationship between tenure options and sustaining agriculture.

Learning outcomes

1. Ability to evaluate tenure options available to them and make informed decisions regarding the best fit for their farm goals.

Key points of information

- There are two basic tenure options: ownership and non-ownership (tenancy). Within this framework, there are variations that are described in this module and Module Two.
- Ownership is the most straightforward tenure model, and as described in Topic I above, rooted in strong cultural and political traditions. For many farmers, land ownership is a core value and goal. Others feel differently about property ownership and prefer not to own land at first—or ever.

  For fuller discussions of property ownership and values see:

  - Equity Trust
  - E.F. Schumacher Society
  - Property and Values: Alternatives to Public and Private Ownership edited by Charles Geisler and Gail Daneker (full reference at the end of Topic 2)
- The basic non-ownership tenure option is tenancy—an agreement between a landowner and a farmer for certain rights to occupy and use certain property for agricultural enterprise. Within tenancy, there are variations as to the length of the lease, the ways the rental rate is calculated, the permitted uses, and how responsibilities, such as for maintenance and repairs, are divided.

Rights and responsibilities

Tenure is based on an articulation of rights and responsibilities. For a landowner, these rights and responsibilities are largely determined by land use laws such as zoning. For a tenant, these rights and responsibilities are spelled out in lease agreements. These can be informal, annual and verbal, or they can be formal, written documents for up to 99 years with rights to build personal equity, pass the leasehold to heirs, and mortgage.

Any tenure situation should reflect the following:

1. Access
2. Affordability
3. Security
4. Use

1. **Access**: This includes the particular user's rights to get onto and control the land sufficiently to meet farming goals. If a farmer owns the land, he or she enjoys maximum rights and control. Tenancy offers a farmer access to the property, subject to the conditions in the agreement. In practical terms, access also means that the operator must be able to get to and onto the land without undue constraint. For example, if a landlord keeps the gate to the leased property locked or blocked, the tenant may have an agreement to use the land, but experiences barriers to access.

   Access also implies a broader social goal to foster opportunity for new and expanding farmers. Rising land values, competition for good land, and declining farm profitability make it harder and harder for entering farmers to acquire land—either through purchase or rental.

2. **Affordability**: The cost of land acquisition has to be reasonably proportioned to the farm enterprise. Many farm business management specialists will argue that it makes more sense for a beginning farmer to start on rented land and build equity, than to start off with land debt. Each farmer needs to pencil this out for him- or herself. Some long-term leases build in affordability provisions, so that the land is affordable for farming in perpetuity.

3. **Security**: This means that the farm operator is free from fear that he or she will be arbitrarily kicked off the land, or that the terms of use will be altered without due process. Land ownership is the most secure tenure. It also means that the length of the lease agreement is sufficient for the farmer to meet his or her goals. While shorter leases offer flexibility, the longer the lease, the more secure the tenure. While the research is inconclusive, common thought is that the longer the lease, the more likely the tenant is to treat the land well, rather than mine it for short-term gain. Certainly longer-term agreements are more likely to foster longer-term conservation practices such as crop rotations, fallowing and application of certain soil amendments.

4. **Use**: A farmer who owns the land is free to use it, subject to laws and regulations. Sometimes local and state laws can significantly impact a farming operation. For example, wetland laws, definitions of agriculture, parking (e.g., for a farm stand), noise and nuisance regulations, may constrain operations on the land.

A tenant's uses are subject to the terms of the lease agreement in addition to applicable laws. In some lease agreements, the limits to use are very specific, such as requiring organic practices or prohibiting the cutting of trees.

Classic acquisition (ownership) options

1. **Fee title purchase with conventional financing**: This is the standard means of purchasing a farm. It involves borrowing the money from a willing lender such as a bank, and paying the mortgage. The borrower will have to prove sufficient means to pay the monthly mortgage, plus a convincing business

plan. Both may be difficult for a beginning farmer. Frequently, a farm property includes a house, which makes it all the more expensive. In this scenario, the farm may be bought and sold between family members or unrelated parties. Sometimes the owner is willing to sell at a **“bargain sale”** price—less than the market price.

2. **Fee title purchase with government financing**: The USDA Farm Service Agency is the traditional “lender of last resort.” FSA has a suite of loan programs targeted to beginning farmers. It provides operating and real estate loans with funding that Congress appropriates each year. Here are FSA’s programs for real estate acquisition:

   a) Real Estate—Direct Loan: Available strictly for real estate purchases, loans are available at subsidized interest rates to both beginning and experienced farmers. In the 2008 Farm Bill the loan limit was raised to $300,000.

   b) Real Estate—Down Payment Assistance: FSA requires the beginning farmer to provide a 5 percent down payment and will then provide up to 45 percent toward the purchase, not to exceed its appraised value and not to exceed $500,000. With this $500,000 cap, the maximum FSA loan amount is $225,000. Note, however, that this is a cap on the amount of the FSA portion of the loan, not a cap on the value of the land to be acquired. The remaining 50 percent then comes from conventional sources, such as the local lender or seller-financing, with amortized payment over a 30-year period. The FSA loan term is 20 years, with an interest rate that is 4 percent lower than the regular FSA direct farm ownership loan interest rate, but no less than 1.5 percent.

   c) Real Estate—Joint Financing 50/50: This program does not require a down payment by the beginning farmer. FSA will provide up to 50 percent of the financing at an interest rate the same as the regular direct farm ownership loan program.

   d) Real Estate—Guaranteed: FSA offers loan guarantees of 95% of the principal amount of a loan from another lender.

   e) Land Contract Guarantee Pilot: In the 2008 Farm Bill, this program was expanded from a pilot program in a few states to permanent and nationwide. It guarantees loans made by private seller of farm or ranch to qualified beginning farmer or rancher on contract land sale basis. It sets minimum down payment for participants of 5%, maximum purchase price of $500,000, and loan period of 10 years. The program offers sellers choice of guarantee options.

   For more information on FSA loan programs for beginning farmers, contact the county USDA FSA office http://www.cfra.org/files/BeginningFarmer_%20Financing_Strategies_0.pdf

   An overview of FSA loan programs is available from the Center for Rural Affairs website: http://www.cfra.org/resources/Publications/Beg_Farmer_loan_programs.htm.

3. **Farm Credit**: The Farm Credit System is a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. The U.S. Congress authorized the creation of the first System institutions in 1916. Farm Credit is organizes into regional associations; each offers a range of financial services including loans. Farm Credit has a Young, Beginning and Small Farmer initiative that targets services and loans to beginning farmers and ranchers.

   Farm Credit offers a Young & Beginning loan for less-established producers (http://www.fcsamerica.com/3f2f8c63-2c99-415f-a24c-3b1581d3262d.aspx). This program is designed for producers age 35 or younger, or with 10 years experience or less.

4. **Aggie Bond Programs**: Through these federal-state partnerships, states can assist beginning, first-time farmers to purchase land, farm equipment, farm buildings and breeding livestock through reduced interest rate loans. Through an Aggie Bond program, the state coordinates the creation of a bond that allows lenders to earn federally-tax exempt interest income on loans to eligible beginning farmers and ranchers. The tax-savings allows the lenders to provide the loans at a reduced interest rate to the first time farmer, while the credit decisions and financial risk remain with the local lending institutions. Not all states have aggie bond programs. http://www.stateagfinance.org/directory.html

5. **Land contract or installment sale**: An installment sale or land contract sale is an agreement through which the seller (original owner) of the land agrees to finance the sale to a new buyer. The new buyer moves onto the land and begins making payments directly to the seller/owner based on an agreed-upon interest rate and other terms. The title remains with the owner until all payments are made. This option can be played out between family generations or unrelated parties.

   The 2008 Farm Bill includes a program in which the federal government guarantees land contracts, making it more attractive (less risky) for the owner to enter into a contract sale. (See above.)

6. **Purchase money mortgage**: This is similar to a land contract, but here the title is passed to the buyer, subject to a mortgage from the seller. This tool is often used in conjunction with bank financing.

7. **Inheritance**: Property left to a child, other relative or non-family member at the time of death. If the deceased had a will, it stipulates how his or her assets are to be distributed. Sometimes the farm real estate goes to one child and other assets go to others. Sometimes the farm goes to all children and they have to figure out how to deal with that. Sometimes there is debt that accompanies the asset. Good estate planning is essential, and estate taxes can be avoided or minimized.

8. **Gift**: Real estate can be gifted from the owner during his or her lifetime to another party such as a beginning farmer who may or may not be a family member. Each person has a $1,000,000 lifetime gift exclusion (under present law). Therefore, if a farm's FMV is less than this threshold, no gift tax is due, however a gift tax return is required to be filed to declare the use of the "lifetime" gift. A sale for less than FMV, may trigger a gifting situation, generally a "gift sale" is one that is at less than 80% of FMV. If done at say 70% of FMV, the gift is the 30% difference from "true FMV." 2009 Federal Tax Policies and Farm Households

9. **Work-in**: In this scenario, a young farmer joins the senior farmer's operation, typically starting as an employee and working up to an equity position as a partner or member of the farm business company. Assets (and management) are transferred gradually.

Non-ownership (tenancy) options

These options and others are more fully discussed in Module Two. In tenancy models, the agreement (preferably written) specifies who is responsible for what maintenance and repairs. It also addresses improvements; for example, whether the tenant is allowed to invest in the property and how s/he is compensated for that investment. For example, the tenant could take the improvement with him or her, depreciate it over the life of the improvement (assuming this is not longer than the length of the lease) or sell the residual value of the improvement back to the landlord or to the next tenant.

1. **Short-term rental**: Typically one to three years in length, often annual, verbal ("handshake") agreements. In Iowa and Nebraska, a *Beginning Farmer Tax Credit* provides an incentive to current and

retired farmers who rent agricultural assets to a beginning farmer. The owner receives a tax credit for several years based on the value of the lease. http://www.iada.state.ia.us/begin_farmer_tax.htm and http://www.agr.state.ne.us/division/med/begfrm.htm

2. **Long-term lease**: May be up to 99 years; a more complex document, always in writing. In a **ground lease** the tenant leases the land long-term, and owns the improvements (e.g., house, barns) upon the land. In some states, the length of a lease term is limited by state law (e.g., cannot be longer than 15 years).

3. **Lease with option to purchase**: Option to buy the property is written into the lease agreement. The price and terms of the purchase are set forth in the lease. The lease payments are not part of the purchase payment unless specified in the lease. There are two common forms: the “straight option” and the “right of first refusal.”

4. **Sharemilking**: In a sharemilking agreement, a young farmer operates a farm on behalf of the farm owner for an agreed share of farm income and expenses. The arrangement offers young farmers a way to build assets and dairy management skills without requiring a large amount of capital input at the beginning of their careers. The sharemilking model can be adapted to non-dairy situations. For more information see Module Two, topic III.

Discussion questions

1. What characteristics of an agricultural operation must be considered (e.g., crop rotation, livestock watering, organic certification) when weighing land tenure options?
2. What are the pros and cons of the classic ownership models described in this module?
3. What are the best tenure conditions to support good land stewardship? Why?
4. Of the land ownership options listed above—which seem the best for a new farmer and under what conditions? Why?

Activities

1. Students choose 2 options and compare and contrast based on criteria they determine necessary for a successful agricultural enterprise. (Divide class into small groups or 3 or 4 and have them list criteria necessary for leasing options to be a success. Then they choose or instructor assigns 2 of the options described above to rate according to their criteria.)
2. Use Tenure Options decision tree for class discussion. (Reprinted with permission.)
3. Students seek examples of the following traditional lease options with current pricing—where to look: Ag review (NC), SDA web sites, Land Link sites. Assign one per student/ group—have them present their findings in the following class period.

Guest speakers

1. Local FSA personnel about preparing to seek credit and other forms of financial backing.
2. A new farmer to talk about his/her experience in accessing land.

Questions for use with the Tenure Options decision tree

1. What are the advantages and disadvantages for each of the options?
2. Are there other options that the students can think of?
3. Can the students create a tool for weighing these options? What factors need to be considered?

Case study #1

The Janzens.

Making the transition from conventional to organic agriculture, or from one generation of farmers to another, can be such a difficult process that a farm may not survive the change. But one Kansas family discovered that managing both transitions at once allowed them to save the land they all loved.

Study questions for the student

1. What are some of the issues that the Janzens were dealing with regarding the future of the family farm?
2. What is the first step taken by the family in trying to identify these issues?
3. What are some of the solutions that were discussed for the farms future?
4. What factors may help this transition succeed?
5. How is this family's situation similar to many farm families in the U.S. today?
6. Who has ownership of the land and how is tenure planned for the foreseeable future?

Case study #2

Good Humus Farm.

This farm established a shared equity agricultural easement for their farm. To establish such an easement, a publicly funded land trust purchases the nonagricultural value of the property. Legally binding restrictions are then placed on the farm's deed which ensures that the land will be kept in active farming use, will be farmed with environmentally responsible methods, and will be valued solely on the basis of its agricultural value in the establishment of any future resale price. This case study can help students to understand the relationship between tenure options and sustaining agriculture.

Study questions for the student

1. Why is the shared equity easement a desirable option for this farm?
2. How will the establishment of this easement help future farmers realize their farming goals?
3. What are the necessary components to the successful establishment of an equity easement?
4. By establishing such an easement for this property, what are some of the options/practices that are now "off the table" as far as future farmers are concerned?
5. Put yourself in the place of a new farmer at Good Humus. Share your own thoughts about how their proposed agreement would impact your farming goals.

Sources

- **Equity Trust** is an organization whose mission is to promote equity in the world by changing the way people think about and hold property.
- **E.F. Schumacher Society** promotes the building of strong local economies that link people, land, and community. To accomplish this we develop model programs, including local currencies, community land trusts, and micro-lending; host lectures and other educational events; publish papers; and maintain a library to engage scholars and inspire citizen-activists.
- Property and Values: Alternatives to Public and Private Ownership edited by Charles Geisler and Gail Daneker. 2000. Island Press.
- **Center for Rural Affairs** Strategies for Financing Beginning Farmers
- **Center for Rural Affairs** USDA Farm Service Agency Beginning Farmer Loan Programs
- **The Farm Credit Services of America** young and beginning farmer program
- **The National Council of State Agricultural Finance Programs**, state by state listing of available programs