Module Two: Tenancy and landlord-tenant relations

I. Types and benefits of leasing

II. Lease terms

III. Incorporating conservation goals in leases

IV. Communications and negotiation skills

Topic I. Types and benefits of leasing

Learning objectives

1. Gain an understanding of the importance of leasing.
2. Determine the reasons for using farm leases.
3. Understand and differentiate between different types of leases.
4. Evaluate advantages and disadvantages of different types of leases.
5. Interpret and explain key questions related to leasing decisions.

Learning outcomes

1. Understanding of the importance of lease agreements and how different types of leases are organized.
2. Acquired ability to develop and use lease agreements when securing land.

Key points of information

Definition of a farm lease: a legal instrument that describes the business agreement between the landlord and tenant. It provides the basis for combining the landlord's and tenant's resources of land, labor, capital, and management to produce farm commodities. (ISU Extension, 2003)

The future of U.S. Agriculture depends on the ability of new generations to establish successful farms and ranches. One of the biggest challenges to entry is gaining access to and control over affordable and secure farmland. Within United States agriculture, land ownership accounts for about two-thirds of the total asset wealth (Janssen 1993). Since land is agriculture's principal asset, how it is held and controlled has serious implications for farming (Rogers and Wunderlich 1993:2). Current and beginning farmers have to gain access to land in some fashion, whether through purchase, gifting, rental, or other, more innovative land arrangements.

On farms with annual sales of over $25,000, 60% of farm operators lease some or all of their land.

Tenure and Size of Farm (by Sales) 2002			
tenure:	Full	Part	Tenant
gross sales:			
< $25K	78%	16%	7%
$25–$500K	40%	49%	11%
>$500K	40%	50%	10%

Source: 2002 Census of Agriculture

According to the 2002 Census of Agriculture, 37.7 percent of farmland was leased in 2002, and 40.3 percent was leased in 1997 (USDA 2004). Over 88 percent of landlords are non-operators (AELOS 1999), and the land they own represents 42 percent of the nation’s farmland (Hoppe 2006).

Land is an expensive farming resource. Land values are increasing; 23 percent increase in per-acre value between the 1997 and 2002 (NASS).

Both cropland and pastureland values reaching record highs amid regional increases from nine to 18 percent (Rater 2007).

Traditional leases are typically separated into broad categories based on method of payment (cash-rent or crop-share) and duration of the lease (annual, short-term). The majority of farmland leases are short-term with most being renewed or terminated on an annual basis. Most are oral, handshake agreements. Some of these less formal agreements have sustained for twenty years or more. Farm lease agreements determine the arrangements for sharing farm income and expenses as well as other terms of the rental.

Farm leasing goals

An effective farm lease agreement must help both the owner and the operator accomplish their goals for leasing the land. Farm landlords commonly have some of the following goals:

- Earn a competitive return on their investment.
- Maintain the productivity of the land and improvements.
- Maintain the appearance and usefulness of buildings and improvements.
- Maintain financial risk at a level that is compatible with their own financial security and comfort level.
- Minimize conflicts with tenants.
- Contribute to better environmental conditions.

- Minimize decisions about property maintenance and related costs.
- Help younger farmers and/or family members get started in farming.
- Reduce income, social security, property and estate taxes.

Farm tenants also have goals. Many of them are compatible with the owner's goals, but some may lead to conflicts that have to be resolved:

- Earn a competitive return on their labor and investment in machinery and inputs.
- Reduce their financial risk.
- Increase the security of being able to operate the property in the future.
- Maintain a scale of operations that utilizes their time and resources efficiently.
- Enjoy managerial freedom
- Have access to land for farming without going into debt by purchasing
- Explore farming and/or marketing systems, location and farming lifestyle without committing to a property

In fact, ***goal setting*** is the first and most important step for each party to a lease agreement. Ideally, landlord and tenant set forth their own goals in consultation with family and professional advisors. Once the goals of each party have been articulated and shared, the next step is to develop a written lease agreement that will combine the goals and resources of the owner and tenant into a package. The agreement should encourage use of the optimum levels of technology, capital, labor, and management for profitable operation of the farm.

Consideration should also be given to yield and price risk and who will bear them. The division of risk is key in determining what kind of lease is acceptable to both parties. Finally, the question of what costs or resources are contributed by each party must be answered. The terms of a lease contract should be viewed in total to determine fairness to both parties involved. Individual provisions should be written so that they contribute to the equity of the lease as a whole.

New production technology, changes in USDA farm programs, new environmental and safety regulations, and markets for new products may require modifying lease terms. Also, each party might modify goals or plans over time. The lease agreement should be reviewed and discussed at least annually. Written lease forms are available from various sources. Some of these are listed at the end of this module. Such forms are valuable as a starting point, but need to be customized to fit each individual situation.

Types of leases

There are different types of farm leases. One category refers to the length of the lease. Another describes the payment terms. Regarding length, a short-term lease is generally annual or up to 3 years). Often such agreements are oral "handshake" agreements. A lease may have a "rolling" long-term where, for example, a three-year lease is renewed annually for another three years. A longer-term lease can be for 5, 10, 20 or more years—up to 99 years, the legal limit after which ownership is assumed. In a ground lease (usually long-term) the tenant rents the land but owns improvements on it. Lease-to-own models provide mechanisms to move from leasing to ownership. Leases can cover farm buildings, equipment and livestock. Residential leases address farm family and/or farm labor housing and are typically separate from the other leases described here.

For further information on leasing and different types of leases refer to:

- Minnesota Department of Agriculture: Selecting a Lease Type
- Land For Good: Is Farm Leasing Right for You?
- Holding Ground: A Guide to Northeast Farmland Tenure and Stewardship
- Equity Trust
- Iowa State online course on farm leasing arrangements
- University of Illinois Extension: Farm Leasing
- Crop Share or Cash Farm Lease Template

Traditional (short-term) leases. Most agricultural leases are short-term. They can offer both flexibility and some stability. There are disadvantages too, such as lack of security and inability to build equity. Renting land rather than owning it means that farmland cannot serve as collateral, so some loans may not be available.

Additionally, rental land doesn't add to the accumulation of property wealth or the possibility of retirement income. Further, even if farmers' operations are not profitable, they are contractually obligated to continue paying rent. Some less traditional lease models address some of these shortcomings. Most short-term leases are between private parties, and sometimes within families. They are frequently verbal arrangements, rather than written.

Alternatives to traditional leases

1. ***Long-term Leases***. Long-term leases are far less common than either annual or short-term; they typically last for a minimum of 5 years and can be up to 99 years, allowing assured continuity and more opportunity for tenants to plan and invest in the farm business and the farmland. In some states long-term leases may be inheritable or the tenant may sell the lease to another individual. Some states limit the allowable length of the lease term. Longer leases allow farmers to introduce long-term planning into their operation (even intergenerational, if it is inheritable) and give them time to benefit from stewardship and farm infrastructure investments. Longer leases could give beginning farmers not only the opportunity to make long-term plans for their farming businesses, but could also improve banks' willingness to provide loans to them.
2. ***Lease-to-Purchase Arrangements***. There are two basic types of agreements that enable a tenant to acquire ownership of the rental property in the future. In a Lease with Option to Purchase the lease grants the tenant an option to purchase the property at a time in the future. Usually the price and the terms of the purchase are set forth at the outset. The option may run for the length of the lease or for only a portion of the lease period. The lease payments are not part of the consideration of the purchase price unless the terms specifically allow for that. In a Lease-Purchase Agreement, the tenant leases the property and is obligated by the terms of the lease to buy the property. Here too, the rent can go toward the purchase price.

3. ***Incubator Farms***. Incubator farms provide beginning farmers with hands-on training in agricultural practices on a small plot of land given, loaned, or leased to them. In this way, a new farmer can gain experience as a farm operator without facing the level of risk he or she might deal with when farming alone. The basic concept is that the program hosts and trains farmers as they grow crops, share equipment, establish their markets, and learn from their mistakes, successes and fellow producers.

   In most incubator farms, the farmer's rent for land is partially or totally subsidized at least in the beginning. In some cases, rent is gradually raised until it achieves market rate. Then, once their businesses are viable, they spin off of the incubator farm and find their own land (Hubbard 2006:1).

   Incubator farm programs such as the Intervale Center in Vermont, the Agriculture and Land-Based Training Association (ALBA) in the Salinas Valley, California, the University of California Farm Incubator Project in Fresno County, California, and the New American Sustainable Agriculture Project (NASAP) in Lewiston and Westbrook, Maine (Hubbard 2006) provide examples.

4. ***Land Trusts***. There are two main types of land trusts: conservation land trusts and community land trusts. Conservation land trusts (LTs) tend to focus on natural resource preservation such as wilderness, open space, and wildlife, but can include agricultural and forest lands. There are over 1700 LTs in the U.S., although the vast majority of them do not focus on agriculture. Community land trusts (CLTs) are more often utilized in lower-class urban areas and address the problem of affordable housing.

   LTs can hold easements on farmland. At minimum the easement removes the right to develop the property which is presumed to lower its value, making it more affordable for a farmer to purchase. In some easement programs, however, the market value of the restricted property escalates beyond the agricultural value. Some public and private easement programs have solved this problem by limiting the resale value of the restricted property to its ag value. In terms of leasing arrangements, the landowner still owns the land and retains the right to lease. If a tenant rents land with an easement on it, it's important to know what's in the easement. Sometimes easements include restrictions on the use of the property, and these restrictions apply to the tenant or any other user. For example, the easement might require organic methods or prohibit certain kinds of livestock. It might require a conservation plan subject to annual review. It might require that that land be continually actively farmed.

   CLTs generally hold title to a property. In the case of agriculture, a CLT would acquire a farm and offer a long-term (99-year) ground lease to a tenant. The tenant may purchase or build and own a house and other improvements on the rented land. This model is not dissimilar to a condominium, wherein the inhabitant owns the dwelling but not the land under it. If the farmer wishes to move on, s/he sells the improvements to the next tenant, or back to the CLT. Usually resale is subject to an affordability cap, preventing the current owner from speculating on the value of the house, and assuring future affordability), providing residents with an inheritable lifetime lease.

   For more information on conservation and community land trusts:

   - Land Trust Alliance
   - Equity Trust
   - National Community Land Trust Network

5. ***Public, institutional, and other non-individual landowners***. Farmers may not normally think of investigating institutional or non-individual landlords. However, landowners such as towns or municipalities, religious organizations, and colleges and universities hold lands that they may be willing to make available for leasing. Many states have programs that offer state-owned land for lease or license. Responsibility for public land management can thus be shared while both parties benefit. There may be specific requirements or prohibitions regarding certain practices or land uses. Lease terms and payment options are basically similar to private lease agreements.

   Churches and religious orders with land holdings are often interested in land uses that meet their stewardship ethic. In addition, some prioritize farming, food security and/or opportunities for socially disadvantaged, minority and other populations. This can include beginning farmers. Members and representatives of religious orders expressed anxiety over the fact that farmland in their possession was going underutilized or unused altogether. One order owns about 4,000 acres in New Jersey. To the distress of the inhabiting sisters, these acres are going back into woodland because they aren't being actively farmed. As with public or institutional lands, these properties are not owned by a single person or family. This adds another layer to the negotiation, and must be taken into account when attempting to secure land arrangements with them.

6. ***Urban Agriculture.*** Urban agriculture can be defined shortly as the growing of plants and the raising of animals within and around cities. The most striking feature of urban agriculture, which distinguishes it from rural agriculture, is that it is integrated into the urban economic and ecological system: urban agriculture is embedded in—and interacting with—the urban ecosystem. Such linkages include the use of urban residents as laborers, use of typical urban resources (like organic waste as compost and urban wastewater for irrigation), direct links with urban consumers, direct impacts on urban ecology (positive and negative), being part of the urban food system, competing for land with other urban functions, being influenced by urban policies and plans, etc. Urban land ownership and use patterns and challenges are different from those in rural settings. Sometimes an organization has control of a small patch of urban land and will rent to a grower.

   For more on urban agriculture please refer to:

   - Heifer's Urban Agriculture Projects
   - Jones Valley Urban Farm
   - Urban Agriculture: East New York: Local Farmers

Calculating lease fees

There are two basic ways to determine lease fees:

Cash leases. Cash lease payments are a fixed amount, usually calculated based on the market. They are simple and straightforward. They do not take into account yield, price, cost of production, or other variables during the current year.

Considerations when setting a cash lease:
http://www.agecon.purdue.edu/extension/pubs/LeasePointsConsider.pdf

See the link to the ***Cash Rent Estimator Spreadsheet*** in the Activities section below.

Share Leases. A crop or livestock share lease can save a farm operator a substantial amount up front. Cash-rent leases are usually re-negotiated on a yearly basis, and farm landlords often increase rent when prices are high. With cash rent leases, in addition to paying rent, the farmer is responsible for all inputs, equipment, and labor. All of this raises the budget of a farming operation exponentially. Crop share leases typically distribute at least some expenses, such as a proportion of inputs, to the landowner. Therefore, crop share leases can substantially lower the financial burden of gaining access to land, as well as the risk to the tenant. These lease arrangements can free up money or keep farmers from bearing all financial risks on their own.

For more information regarding crop share leasing please refer to:
http://www.extension.iastate.edu/agdm/wholefarm/html/c2-30.html

A third approach, the ***flexible cash lease*** is a sort of hybrid between cash and share leasing. Flexible cash lease arrangements establish a baseline rent figured for low commodity prices or low production output. When prices or output exceed expectations, the farmer increases payment to the landowner according to an agreed-upon formula. Flexible cash rent reduces some of the risk to the tenant of a bad year and rewards the landowner in good years.

See the link to the ***Flexible Rent Analysis Excel Spreadsheet*** in the Activities section, below.

Leases to transfer assets as part of a succession plan

(from *Holding Ground*, Chapter VI: Paths to Ownership. Reprinted here with permission.)

"Good farm business succession planning involves a systematic transfer of the income, managerial control, and assets of a farm business from one generation to the next. Farm business successions have become increasingly difficult, partially due to declining farm profitability and partially because many aging farmers do not understand farm succession planning. Leasing is an excellent tenure tool to enable a successful, gradual transfer because it can enable possession and control of land, buildings, machinery and equipment, or livestock without purchasing them outright. Instead, it allows a gradual transfer of management and ownership from the farmer to the successor, giving both parties substantial financial advantages and also allowing the owner to mentor the successor.

A lease can transfer use and possession of short, intermediate, and long-term assets to the successor generation. Long-term assets (land) may be leased for longer periods of time. In some cases, long-term leases of land may last many decades and may even be passed through an estate to an heir.

Advantages of leases in succession plans for the tenant:

- Tenant incurs less debt to acquire the asset
- Tenant controls the asset without the costs of ownership
- Tenant can deduct lease payments as a business expense
- Tenant gains increased business planning flexibility through the use of debt to acquire the most profitable mix of assets
- The duration of the lease can be proportional to the length of time the asset is needed in the business

Disadvantages of leases in succession plans for the tenant:

- Tenant may face restrictions on the use of assets
- Tenant may be limited in managerial decisions by certain lease provisions
- Tenant is unable to build equity in the asset
- Tenant does not have collateral for needed loans

Leases in farm succession planning are typically either a whole farm lease or a lease of a particular asset or set of assets used in the farm enterprise. The process of creating a lease used to transfer land assets begins with the inventory and appraisal of the asset to be leased. Lease-purchase agreements or a lease with an option to buy are common arrangements for land. A lease with an option to buy is useful when transferring land because it allows the tenant to postpone purchasing the land to a later date.

Many older farmers see leasing as their retirement plan with transfer taking place when they need additional assets to pay for long-term care or at their death. This can be a concern in leases as part of a succession plan and should be discussed, written and agreed upon by all parties."

For more information on short- and long-term leases, and leases in succession planning, refer to *Holding Ground.*

Discussion questions

1. Why is a written lease agreement important to both parties?
2. What basic information is necessary for developing an effective farm lease?
3. What factors are important to the farmer/tenant and the landowner in the lease agreement?
4. What are the benefits of share leases for tenants and landowners? Why are share leases not more commonly used?
5. What are some alternative lease agreements that may provide additional options for both landlords and tenants?

Activities

1. Identify a lease agreement option and determine what information needs to be included. Have students develop their own written lease agreement for a specific situation.
2. Have students work in small groups to determine the advantages and disadvantages of different types of lease agreements. Share the findings with the entire group and use to start a discussion on types and benefits of different lease agreements.
3. Have students compare the “ideal” of ownership to the benefits of leasing.
4. Have students investigate local example of the different ‘alternatives to traditional leases’ and share those example with the class.
5. Use these cash and flexible rent calculators to review two common types of lease agreements.
   - Cash Rent Estimation Spreadsheet
   - Cash Rent Estimation Activity
   - Flexible Lease Agreement Spreadsheet
   - Flexible Lease Agreement Activity along with the following information file: http://www.extension.iastate.edu/agdm/wholefarm/html/c2-21.html
   - Analyze and discuss crop-share leasing provisions using the crop-share leasing activity and the following website: http://www.extension.iastate.edu/agdm/wholefarm/html/c2-30.html

Guest speaker ideas

Local University and/or Extension office regarding leasing information in your area.

Case studies

Woloschuk: The Possibility of a Farm

Leasing Public Lands and http://www.cvcountryside.org/Website/countryside_initiative/cvnp_farming.htm

Non-Traditional Agreement

Benefits and use of lease-to-own.

Sources

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