Overview of Farm Leases & Other Types of Common Leases Used on a Farming Operation

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I. GENERAL CONSIDERATIONS

A. Oral vs. Written Leases

1. ***What is Currently Being done***

   a. The agriculture industry tends to be a conservative "handshake" culture with many oral agreements.

   b. In a Kansas State ("**K-State**") study, about one-half (50%) of farm and ranch leases in Kansas were in writing while the other half were oral agreements. See Llewelyn et al., "Learning from Lease Workshop Participants: Results of In-Session Audience Responses," Kansas State University Lease Workshops (2011, 2012, and 2013) at 4 available at http://www.agmanager.info/farmmgt/land/lease/papers/Lease_Questions_Summary.pdf (last visited June 17, 2015).

2. ***Advantages of Having a Written Farm Lease***

   a. Provides for a guide for the heirs of the operator or landlord –many times the farmers or heirs want to own the farm, but not be involved in the day-to-day operations, so they will lease out the land.

   b. Helps facilitate a conversation between the landlord and tenant

   c. More likely that the parties have read and understood the terms of the agreement

d. Will preserve the specific date/provisions for renewal

e. Clarifies termination procedures

    i. Note: Farm/ranch leases typically terminate upon the death of the tenant.

f. Helps to clear up tax issues

    i. The type of lease you choose may affect tax liabilities.

    ii. Examples:
        1) income tax
        2) self-employment tax
        3) qualifying for special use valuation for estate tax

g. In most states, the Statute of Frauds *requires* farm/ranch leases concerning property to be in writing if 1 year or more; therefore, farm leases longer than 1 year cannot be easily enforced.

    i. Oral leases are presumed to be year-to-year (default) unless there is proof to the contrary.

    ii. Look at the law in your state for the termination and renewal rules with oral leases.

h. If the lease contains a profit share, then the written lease shall provide the landlord proof of his/her share.

i. Written record of the agreement that can be referred back to if a dispute arises

3. ***Client Concerns with Having Written Farm Leases***

    a. Attorneys' Fees

        i. This is one of the biggest deterrents for farmers and ranchers to put their lease in writing. They are typically fearful of having an over-complicated farm lease that they paid and arm and a leg for. Agriculture attorneys should be cognizant of this fear.

ii. This may be an opportunity to think creatively with billing structures.

1) Clients prefer a flat fee for typical farm or ranch lease transactions. See Cari Rincker, "Strategies for Developing and Retaining Farms and Agri-Business Clients," Fifth Annual Ohio Agricultural Symposium (June 23, 2013) presentation available at http://www.slideshare.net/rinckerlaw/stategies-for-developing-and-retaining-ag-clients (last visited June 17, 2015) and "Survey Says: What Farmers and Agri-Businesses Have to Say About Agriculture Lawyers," at 4-5 (June 28, 2013) at http://www.jdsupra.com/legalnews/survey-says-what-farmers-and-agri-busi-19720/ (last visited June 17, 2015).

2) Farm/ranch/livestock leases are a nice opportunity for agriculture lawyers to use flat fee billing vs. the billable hour.

b. Flexibility

i. Some clients prefer to have a "moving agreement" that may morph and change overtime.

ii. Attorneys should stress that farm and ranch leases can be easily amended so long as it is done in writing.

B. Picking the Right Landlord or Tenant

1. It is important for the Landlord and the Tenant to both consider what is most important to them when picking a right Landlord or Tenant.

2. It is recommended that the Landlord request a resume since many times landlords acquire tenants who they have never met before vs. someone they met through the community. See Drake University Agricultural Law Center's "Talking to Your Tenant" available at http://sustainablefarmlease.org/2010/08/talking-to-the-tenant/ (last visited June 17, 2015).

C. <u>Active v. Passive Income</u>

1. ***Social Security***

    a. In way of background, you must have a certain number of credits under the social security system before receiving social security based eligible quarters.

    b. A farmer may have already obtained this threshold with the Social Security Administration ("SSA") as he/she nears retirement.

    c. Farmer clients should speak to their accountant if social security is an issue.

2. ***Self Employment***

    a. According to the IRS in the "Farmer's Tax Guide", a person is self-employed if they carry on a trade or business (such as farming) in good faith to make a profit. IRS Pub 225 specifically covers "Landlord Participation in Farming" on Page 74.

    b. As stated in the publication, "income and deductions from rentals and from personal property leased with real estate are not included in determining self-employment earnings." However, income from farm rentals will be included if the **landlord materially participates in the production or management of agriculture production**. The issue is really whether the rental income is considered active or passive income.

    c. The next question is what entails "**material participation**" in this context. In order to "materially participate" in the production of agriculture, the IRS requires the landowner meet one of the following four tests:

        i. <u>Landowner does three (3) of the following four (4) things</u>:

            1) Pay at least 50% of the direct costs for producing the crop or livestock;

2) Furnish at least 50% of the tools, equipment and livestock used in the production activities;

3) Advise/consult the tenant; and or

4) Inspect the production activities periodically;

ii. Regularly and frequently takes part in important decision-making and management of the farm affecting the success of the operation;

iii. Works 100 hours plus directly connected to agricultural production over period of 5 weeks or more; or

iv. Looking at "big picture," the landowner is materially and significantly involved in the production of farm commodities.

See also Robert Fleming, "Tax Issues for Farm Rental Agreements," The Ohio State University Extension, FR-6-02 available at http://ohioline.osu.edu/fr-fact/0006.html (last visited June 17, 2015).

D. FSA Compliance - If applicable, both the landlord and tenant should ensure that the farm lease complies with the USDA Farm Service Agency ("**FSA**") federal farm program regulations.

1. Cash rent tenants are entitled to all of the federal farm program payments; crop share tenants are required to share direct and counter cyclical payments with their landlord

2. If the lease does not comply with these regulations, then they may be required to repay federal farm program payments.

3. With hybrid leases, it depends on how the lease is drafted on whether the farmer is actively engaged in farming

II. FARM LEASES

A. Basic Types of Farm Acreage Leases

1. ***Cash-Rent Lease***: This is where the tenant usually pays a ***fixed dollar amount*** in rent (either on a per acre or whole farm basis). This can include the use of land, buildings, and other facilities.

    a. This type of lease may be modified depending on ***crop yield*** (i.e., increase in good years and decrease in bad years).

    b. Cash-Rent leases include the amount and terms of payment, the time period, and any restrictions the landlord may put on the land, building, or other facilities covered in the lease.

    c. <u>From the Landlord's Perspective</u>:

        i. Advantages (less risk on the landlord)

            1) Less managerial input/labor

                a) Landlord does not have to plant, harvest or market the crop

            2) Less paperwork/ administrative headache

            3) Stable/predictable cash rent income

            4) Little concern over the accurate division of crop and expenses and marketing

        ii. Disadvantages

            1) Landlord is not "actively engaged in farming" for federal farm programs

            2) Income for landlord is not subject to the self-employment tax and is not considered to be earned income for the purposes of determining how social security may be modified if the farmer has previously retired.

            3) More difficult to determine a cash rent acceptable to both the landlord and the tenant

a) Challenging to determine the cash rental value of the farmland

4) Landlord may have difficulty in getting paid

a) Check the law in your state on whether a landlord's lien is available. Some states require the filing of a UCC-1 form.

b) The National Agriculture Law Center has a resource for information on liens available in each state.

5) Not able to receive direct and counter-cyclical program payments from the USDA Farm Service Agency.

See Alan Miller, "Cropland Leasing Update: Farm Service Agency Direct and Counter-Cyclical Program Payments and Flexible Cash Lease Arrangements", Purdue University, available at https://ag.purdue.edu/agecon/Documents/Cropland%20Leasing%20Update.pdf (last visited July 5, 2015).

d. From the Tenant's Perspective:

i. *Advantages*

1) The landlord is not as involved in crop production giving the tenant more autonomy. In other words, the tenant has decision-making authority over the farm, including marketing.

a) Tenant has autonomy in crop production, marketing, and participation in federal farm programs

2) If there is a good harvest, the tenant is not required to divide the proceeds with the landlord.

3) He/she has less capital tied up than they would have if they owned the land.

4) Able to receive direct and counter-cyclical program payments from FSA.

See Alan Miller, "Cropland Leasing Update: Farm Service Agency Direct and Counter-Cyclical Program Payments and Flexible Cash Lease Arrangements", Purdue University, available at https://ag.purdue.edu/agecon/Documents/Cropland%20Leasing%20Update.pdf (last visited July 5, 2015).

ii. *Disadvantages*

1) The tenant has increased risk with commodity price fluctuations.

2) Increased risk with short-term leases

a) Capital investments in the property / improvements to the land

3) If the landlord terminates the lease, then the tenant may have difficulty in finding another lease with comparable acres.

2. ***Crop-Share Lease***: In these arrangements, ***the landlord will share input costs*** (including but not limited to seed, fertilizer, fuel) while the tenant provides all of the labor and remaining input costs. Once harvested, proceeds will be divided according to the agreement (normally ranging from 25/75 to 50/50).

a. In this scenario, the farmers both share the risk with the other person and the landlord will typically satisfy the "actively engaged in farming" requirement of federal programs.

b. From the Landlord's Perspective:

i. *Advantages*

1) Rental income will be subject to ***self-employment taxes*** and is considered to be earned income for the purposes of determining how social security may be modified if the farmer has previously retired.

2) Depending on how the lease is drafted, the farmer-landlord could be "actively engaged in farming" for federal farm programs. If so, the landlord should participate in management decisions.

3) Crop sales and input purchases may be timed to help with taxes.

ii. *Disadvantages*

1) Variable income is a disadvantage – accounting should be maintained by the tenant.

c. From the Tenant's Perspective:

i. Advantages

1) Less operating monies are tied up by the tenant because the landlord shares some production costs.

2) Management is shared between an (oftentimes) experienced landlord and (oftentimes) less-experienced tenant.

3) Crop sales and input purchases may be timed to help with taxes.

4) Sharing risk of low yield and prices with the landlord

ii. Disadvantages

1) He/she loses autonomy because the landlord is involved in the decisions of the operation.

2) Sharing profits from the good years

d. Livestock-Share Leases:

i. Most view livestock-share leases as a type of crop-share lease.

ii. The landlord may own portion of the livestock animals and typically shares the burden of input costs, such as feed.

3. ***Hybrid Leases***: In this type of lease, ***the landlord will receive a minimum fixed rent payment*** while sharing in some of the profits, losses, and decision-making. In this lease, the rent is based on a formula that takes into account "actual yields" and "actual selling prices" available to the tenant during the crop year.

   a. <u>Variable Cash Rent Agreement</u>. Cash rents may be flexed for changes in:

      i. crop price and/or yields
      ii. flexing rent on changes in costs of inputs

   b. <u>From the Landlord's Perspective</u>:

      i. Advantages

         1) Depending on how the agreement is drafted and the responsibilities of the landlord:

            a) Rental income may be subject to self-employment taxes and is considered to be earned income for the purposes of determining how social security may be modified if the farmer has previously retired.

            b) The farmer-landlord could be "actively engaged in farming" for federal farm programs.

         2) Allows the farmer-landowner to share in the benefit of above-normal yields

      ii. *Disadvantages*

         1) If the lease isn't properly drafted, then the LL isn't "actively engaged in farming".

         2) Somewhat variable income

c. From the Tenant's Perspective:

i. *Advantages*

1) Reduces financial risk

2) Reduces required labor

ii. *Disadvantages*

1) Less autonomy than cash rent

d. FSA Compliance: If applicable, both the landlord and tenant should ensure that the hybrid farm lease complies with the USDA Farm Service Agency ("**FSA**") federal farm program regulations.

i. Federal farm program payments must be allocated in the same ratio as the crop is divided.

ii. If the lease does not comply with these regulations, then they may be required to repay federal farm program payments.

B. Key Farm Lease Provisions

1. ***Parties***: Ensure that all intended parties to the lease are named and adequately identified by the inclusion of their addresses or other unique identifying information.

a. Agriculture operations oftentimes do business under an assumed name (i.e., a D/B/A or "doing business as" another entity). It is important to obtain the legal name of the landlord or tenant (e.g., Curt and Pam Rincker d/b/a Rincker Simmentals).

b. The parties should be identified as the Landlord/Tenant or Lessor/Lessee.

2. ***Purpose***: It is recommended that farm leases note the purpose of the lease (e.g., corn production, organic cattle production, agri-tourism).

3. ***Property Description***: Ensure an accurate description of the leased ground is included. This should include a list of buildings and structures the tenant has access to.

a. Legal Description: It is preferred to include a legal description of the property.

b. FSA Farm Number: Some farm leases include the USDA Farm Service Agency ("FSA") farm number instead of the legal description of the property.

4. ***Lease Term***:

a. The length of the lease term should be clearly stated.

i. In some states, longer leases need to be recorded.

1) Under New York law, a real estate lease can be for as long as the parties wish; however, if the terms are longer than three (3) years then the lease must be recorded, just like a deed or a mortgage would in the property records office.

2) Check the law on this issue in your state.

ii. Some states have a maximum length of a farm lease.

1) For example, farm leases in Iowa cannot be longer than 20 years.

b. It is usually advantageous for the tenant to negotiate a longer lease.

i. If there is no written lease, then the lease will be inferred to be a year-to-year lease.

c. It should be clear what the beginning and ending date is of the term.

d. In a study performed by K-State University, the length of the leases were as follows:

i. 1 year – 27%
ii. 2 years – 3%
iii. 3 years – 21%
iv. 4 years or longer – 32%
    1) 5 years – 10%
    2) Other – 22%

See Llewelyn et al., "Learning from Lease Workshop Participants: Results of In-Session Audience Responses," Kansas State University Lease Workshops (2011, 2012, and 2013) at 4 available at http://www.agmanager.info/farmmgt/land/lease/papers/Lease_Questions_Summary.pdf (last visited June 17, 2015).

5. ***Renewal Terms***:

   a. Include provisions allowing for any renewal of the lease and for notice of intent to renew (or not renew).

   b. A good farm property lease should also establish agreed-upon compensation for any fall fieldwork completion, in the event of nonrenewal of the lease.

6. ***Lease Price & Payment Terms***:

   a. Whether your agreement involves crop sharing, fixed-cash, flex-cash, or some other arrangement, your lease price should be spelled out in writing.

   b. Payment terms should be memorialized (including when payment is due, where it should be sent, and how/method rent can be paid).

      i. In a K-State study, 53% of survey takers had multiple rent payments taking place annually. Meanwhile 15% had rent due at harvest while 15% had it due January 1. 10% paid/received rent on December 31. Only 3% had rent taking place at the time of planning. See Llewelyn et al., "Learning from Lease Workshop Participants: Results of In-Session Audience Responses," Kansas State University Lease Workshops (2011, 2012, and 2013) available at http://www.agmanager.info/farmmgt/land/lease/papers/Lease_Questions_Summary.pdf (last visited July 5, 2015).

   c. The lease should clearly state who is responsible for property taxes, farm insurance, and utilities.

   d. What is the penalty for late payment?

7. ***Reimbursement of Expenses***: In some leases, the tenant may seek reimbursement for crop nutrients (e.g., lime), the cost of improvements or other operational expenses.

8. ***Duties and Prohibitions***: The lease should clearly state the duties and prohibitions of both the landlord and the tenant in the farm lease.

    a. Desired/prohibited farming practices (e.g., use of certain chemicals)

    b. Maintenance of farm buildings/fences

    c. Controlling noxious weeds

        i. Check the law in your state. In some states, the landlord has the duty to eradicate certain noxious weeds.

    d. Making improvements on the real property, buildings or fixtures including renewable energy improvements (e.g., solar, wind)

    e. Soil-conservation practices

    f. Nature of landlord's participation in the management of the farm (potential tax implications)

    g. Prohibition against agri-tourism/agri-tainment, on-farm direct marketing (e.g., farmstands), on-farm poultry slaughter

    h. <u>Crop-Share</u> - This section is especially important in crop-share leases where each party has specific responsibilities. Here are some examples:

        i. Record-keeping requirements and how will this information be shared and/or kept confidential

        ii. Storage/delivery of landlord's share of crops

        iii. Sharing of operational expenses. Usually, variable expenses are shared in the same percentage as the crop share.

        iv. Compensation upon termination of the lease.

    i. <u>Example Issue Checklist from University of Vermont</u>

- Access
- Ag Support Services
- Cell Phone Reception
- Current Tenant Relations
- Easements
- Equipment Storage
- Equipment Usage
- Housing / Residence
- Infrastructure Usage, Improvements &
- Maintenance
    - Barns
    - Equipment sheds
    - Farm office
    - Farm stands
    - Feed storage facilities
    - Fencing
    - Food processing facilities
    - Greenhouses
    - Irrigation, well, watering systems
    - Mobile livestock units
    - Product storage facilities, coolers, freezers
- Land Orientation
- Livestock
- Microclimates
- Neighbor Relations
- Power Supply
- Property Borders
- Roads
- Records
- Restrictions/Restricted Areas
- Soils
- Topography
- Vegetation
- Water Resources
- Other Considerations

See University of Vermont "Farm Rental Assessment Checklist" available at http://www.uvm.edu/newfarmer/land/checklist.pdf (last visited July 5, 2015).

9. ***Rights to Natural Resources***: The lease should state whether the tenant or landlord will retain rights to natural resources on the property including,

but not limited to: wind rights, solar rights, mineral rights, timber rights, fishing rights and/or hunting rights. It might be appropriate to also describe recreational rights such as camping.

10. ***Access***: The lease should cover access to the farm via driveways or easements.

11. ***Insurance***: Should the landlord or tenant be required to have insurance? If so, how much (and what type) of liability protection is needed?

    a. What Type(s) of Insurance?
        i. Comprehensive Farmowners' Liability Policy
        ii. Commercial Insurance
        iii. Renters Insurance (for farmstead)
        iv. Livestock Insurance
        v. Product Liability Insurance and/or Food Recall Insurance
        vi. Environmental Insurance

    b. What policy limit?

        i. It is recommended that the insurance will cover the value of the land, buildings, equipment and animals.

12. ***FSA Farm Program Payments***:

    a. As noted above, depending on the type of lease, FSA federal farm program payments should be addressed.

    b. It should be identified whether the landlord or tenant will participate in federal farm programs, such as Conservation Reserve Program ("CRP") Payments, Conservation Security Program ("CSP") Payments, or other federal farm programs. In those cases, the lease should describe who will be receiving the federal farm payments.

13. ***Improvements***: Improvements should be addressed in most farm leases, including the rate of depreciation for the tenant's improvement.

    a. Right to make improvement on the real property, buildings, and/or fixtures and the right to be compensated for same.

    b. Importantly, renewable energy or mineral rights should be recognized in the lease. Typically, the landlord reserves the right to these natural resources.

c. Whether the tenant has the right to utilize improvements made by the landlords should be discussed.

d. If improvements are allowed, then also discuss the removal of fixtures.

e. Examples:

   i. Farm structures/buildings
   ii. Limestone
   iii. Fertilizer

14. ***Reporting Requirements***: You should also discuss and include any reporting requirements, such as what must be reported, along with when and how the tenant must make those reports.

    a. For example, does the tenant have to provide ***grid sampling***, ***yield monitor data***, ***weigh wagon*** results or ***test plot*** results to the landowner?

    b. Can the landowner ask the cooperative how many bushels of grain were delivered?

15. ***Fertilizer***: In most farm leases, the issue of fertilizer should be addressed somehow.

    a. Most crop leases stipulate that the same amounts of fertilizer and lime be applied annually.

    b. Some leases state that soil tests should be performed to ensure for proper fertility levels (e.g., flight map/farm plan map with matching soil tests in each filed).

16. ***Environmental Compliance/Conservation***: In some cases, soil conservation provisions should be included in the farm lease.

    a. The drafter may also wish to include a statement regarding the existing environmental status of the property and responsibility to minimize certain activities that may cause environmental contamination.

17. ***Default***: Your lease may include a list of actions that count as defaults in the terms of the lease, specifying whether part or all of the listed defaults can be cured or waived by the other party.

18. ***Ability to Assign or Sublease***: The lease should state whether (or under what conditions) the tenant can assign or sublease its obligation to another farmer.

19. ***Notice***: Include notice provisions, to specify how and when to give notice of default, notice of intent to terminate the lease, or any other notice needed to make the terms of the lease work.

20. ***Termination***: The lease should include procedures for terminating the lease, either voluntarily or involuntarily (for example, in case of a default).

    a. The lease should include requirements for the Notice of Termination. Make sure that the notice provisions comply with any state law requirements concerning notice with farm leases.

    b. It should also note any reimbursement or crop nutrients, lime and/or completed fieldwork upon the termination of the lease.

    c. These provisions should also include the tenant's right if the property is transferred or condemned during the lease period and reimbursement provisions for a crop still in the ground when the lease is terminated.

    See generally University of Nebraska-Lincoln Extension, "Farm Lease Termination," Cornhusker Economics (February 27, 2008) available at http://digitalcommons.unl.edu/cgi/viewcontent.cgi?article=1355&context=agecon_cornhusker (last visited July 5, 2015).

21. ***Landlord Rights***: The lease should discuss the landlord's right to enter the property for narrowly defined purposes.

    a. This typically includes the right to make a reasonable inspection, make repairs and/or installations, show the premises to prospective buyers, collect rent, and deliver a notice to terminate the tenancy.

    b. The lease might also note the landlord's right to a security interest in the crops/livestock, or another means of securing payment.

22. ***Good Management Practices***: Depending on the type of operation, the parties may wish to enumerate good management practices ("GMPs") such as animal husbandry/handling/feeding/nutrition or farming techniques.

23. ***Right-to-Farm***: Most states have their own right-to-farm law.

    a. For example, in New York, if the land is in an agricultural district and the farmer is performing "sound agricultural practices" (akin to GMPs) then nuisance suits are barred. The lease might require the tenant to use said "sound agricultural practices", which are usually not clearly defined. In New York, the New York Department of Agriculture & Markets makes the determination on what is and what is not considered a "sound agricultural practice" and it may consult with the USDA and/or Cornell Cooperative Extension.

    b. Minimally, the lease should recognized that certain parcels of the land are in agriculture districts subject to the right-to-farm law.

24. ***Confidentiality***:

    a. Think about having a confidentiality clause if the parties have not signed a Non-Disclosure Agreement. See Cari Rincker, "Maintaining Confidentiality for Your Farm or Agri-Business with Non-Disclosure Agreements," available at http://www.jdsupra.com/legalnews/maintaining-confidentiality-for-your-far-42640/ (last visited June 17, 2015).

25. ***Miscellaneous Provisions***:

    a. Indemnification Clauses - requiring the tenant to pay any damages that are assessed against the landlord or vice versa

    b. Severability Clause - if a provision in the contract is held to be unenforceable then the remaining provisions in the lease can still be enforced

    c. Choice of Law -Which state law applies?

        i. Typically, the choice of law will be the location of the farm; however, what if the farm crosses state boundaries?

ii. What if the landlord principally does business in another state?

d. Choice of Forum - What court will disputes be dealt with (state law court)?

e. Alternative Dispute Resolution - Can include stages for negotiation, non-binding mediation, and non-binding/binding arbitration.

i. Litigation should be allowed if there is an emergency.

ii. Keep in mind that some states have an agriculture mediation program (e.g., New York Agriculture Mediation Program); however, such programs typically only mediate right-to-farm disputes and federal farm programs. Agriculture lawyers should pay close attention to the types of disputes that may go to the agriculture mediation program.

iii. In New York, every county has a Community Dispute Resolution Center which conducts mediation at no charge.

iv. The American Arbitration Association offers both mediation and arbitration.

f. No Joint Venture - In many cases, it is beneficial for the lease to state that the landlord and tenant are not in a partnership or joint venture. It should also note that neither party will obligate the other party for debts/liabilities or damage of the other party.

26. ***Signature Block***: Perhaps the most obvious component is the signature block; however, it is recommended that the parties also sign before a notary public.

C. Farmhouse

1. Should have a separate lease for residential property.

2. Does the farm lease cover the farmhouse or residential living building?

D. Termination of a Farm Lease

1. Some states use specific forms for farm lease termination.

2. Check the notice requirements in your state for the termination of a lease.

3. Will the lease terminate upon the death of either party?

    a. If either the LL or T dies while the farm or ranch lease is in effect, the deceased's estate executor or administrator is required to comply with the terms of the lease.

    b. However, if the landlord only has a life-estate in the land, then the lease will terminate upon his/her death.

E. <u>Liability for Tenant Activities</u>

1. When is a landowner legally liable for harm that is caused to others by a tenant's activity on leased farmland?

    a. For example, let's say the landlord has a tenant who spreads manure or pesticides on the property might create a nuisance that affects a neighbor, who then wants to sue you because you have more assets or better insurance against which to collect.

    b. The general principle is that everyone who creates a nuisance or participates in maintaining the nuisance is liable. This means that landowners cannot avoid liability simply by leasing their land to tenants – what matters is whether the landowner knew about how the tenant was likely to use the property when the lease was signed or renewed.

F. <u>Getting a Fair Price</u>

1. ***Background***

    a. Farmland rental prices increased sharply in 2011 and 2012 with a moderate increase in 2013. <u>See</u> Erin Herbold-Swalwell, "Legal Must-Know for Farm Lease Negotiations" at 2 National Business Institute webinar on "Farm Leases" (August 2013).

    b. Whether you represent the landlord or tenant, it helpful to know the market rate in your area.

c. Additionally, if the farm is set up in two different business entities with one entity owning the real property and the other entity owning the livestock, crops and farm equipment, an arm's length farm lease should be used between the entities.

2. ***Picking a Fair Price***

   a. Each side must be compensated appropriately.

   b. In a K-State study, most farmers and ranchers believed that the landowner had more power. See Llewelyn et al., "Learning from Lease Workshop Participants: Results of In-Session Audience Responses," Kansas State University Lease Workshops (2011, 2012, and 2013) available at http://www.agmanager.info/farmmgt/land/lease/papers/Lease_Questions_Summary.pdf (last visited July 5, 2015).

   c. Many landlords do not ask for proper rent increases oftentimes because they are afraid to do so.

      i. When representing a landlord, do not be afraid to ask for reasonable rent increases indexed for inflation or reasonable market trends.

      ii. In the same K-State study, cited above, 23% of survey-takers renegotiated the lease annually and 22% renegotiated every other year. 40% said that rent was renegotiated every 3-5 years. 15% survey takers would go more than 6 years without renegotiating the lease. See Llewelyn et al., "Learning from Lease Workshop Participants: Results of In-Session Audience Responses," Kansas State University Lease Workshops (2011, 2012, and 2013) available at http://www.agmanager.info/farmmgt/land/lease/papers/Lease_Questions_Summary.pdf (last visited July 5, 2015).

3. ***Factors Involved in Rent Determination***:

   a. Production Contribution the Farm Can Make to the Tenant's Operation

      i. Is the farm productive?

ii. Are the improvements efficient to his operation?
iii. Is there adequate water?
iv. Are the fences in good shape?

b. Cash Value of the Farm

i. Does the lease reflect the market value of the farm?

c. Comparable Farm Leases in the Area

i. This will require some investigation/ research.

4. ***Where Can You Find the Market Rate***:

a. Nebraska - http://agecon.unl.edu/2015-trends-in-nebraska-farmland-values-and-rental-rates (last visited July 5, 2015)

b. Iowa -https://www.extension.iastate.edu/agdm/wholefarm/html/c2-10.html (last visited July 5, 2015)

c. Illinois - http://www.ispfmra.org/wp-content/uploads/2015/03/2015-Illinois-Farmland-Values-Lease-Trends.pdf (last visited July 5, 2015)

d. Kansas - http://www.agmanager.info/farmmgt/land/lease/ (last visited July 5, 2015)

III. OTHER TYPES OF FARM AND RANCH LEASES

A. Farm Equipment/Machinery Lease

1. Reasons to Lease Farm Equipment and Machinery
   a. Increasing equipment cost
   b. Obsolescence of owned equipment
   c. Limited sources to purchase new equipment

2. Leases for farm equipment and machinery typically last 3-5 years.

3. Responsibilities of the lessee

a. Make payments per the lease (usually in advance)

b. Make insurance payments

c. Pay taxes (if applicable)

d. Pay any operating costs (including maintenance)

e. Provide labor for operating the machinery

4. At the end of the lease the lessee might have an opportunity to purchase the equipment or machinery at a market value.

5. Financing ("capital lease")

   a. This is not a true lease, but is more of a conditional sales contract.

   b. This is not tax deductible, but the depreciation and interest are tax deductible.

6. Tax Implications

   a. Entire lease payments and lease deposits are tax deductible. However, this must be amortized over the life of the lease. For example, if the lease is for 5 years, that deductions must be spread out over 5 years – you cannot take it all in year #1.

   b. Operating costs are deductible as well.

   c. Depreciation and interest deductions are not applicable to people who lease equipment and machinery.

7. Advantages of Leasing Equipment

   a. Lessee doesn't have to sell older equipment and buy new equipment every few years.
   b. Lessee doesn't have to use investment capital.
   c. For farmers who are looking to retire, the lease is short term or can be liquidated.
   d. The lessee can try new equipment for relatively little risk.

B. Custom-Farming Agreements (Custom Hire)

1. Background

   a. This is an alternative to leasing farm land and is a short term agreement for a specific amount of work to be done.
   b. The custom hire provides the machinery, the machinery operator, and is responsible for ownership and operating costs, also referred to as "input costs".

2. Tax Implications

   a. Custom hire charges are tax deductible.

3. Advantages

   a. For the Custom Operator
      i. Receives extra income for relatively little effort and expense

      ii. Fixed return per acre. See e.g., Corn and Soybean Digest's "8 Considerations With Custom Farming Agreements, available at http://cornandsoybeandigest.com/blog/8-considerations-custom-farming-agreements (last visited June 19, 2015).

   b. For the Landowner
      i. Keeps all of the crop yield

      ii. No need to invest in a lot of farm equipment

      iii. Entitled to government farm program payment

C. Labor-Share Leases

1. These leases are most common for tenant farmers that have little equity (and those just starting out).

2. In labor-share leases, the tenant provides supplies, the labor, and all

management. The landowner in turn produces any capital and equipment. See Univ. of California Cooperative Extension UC Small Farm Program's "Farm Leases and Rents" available at http://sfp.ucdavis.edu/pubs/Family_Farm_Series/Farmmanage/leases/ (last visited July 5, 2015).

D. Manure Application Agreements

1. Background
   a. These agreements usually concern hog manure.
   b. A manure agreement occurs when one party has the manure and the other has land needing manure applications.

2. 2 Types of Agreements
   a. There are two common types of manure agreements, which can be combined
      i. "***Manure Contract***"- selling manure via a legally binding contract; and
      ii. "***Manure Easement***"- permitting someone to apply manure to land owned by someone else and paying for the use. In an easement, it should be indicated that the easement "runs with the land"

3. Elements of a Manure Contract
   a. Compensation for the manure
   b. Guarantees of application
   c. Manure type and quality
   d. Application method and compensation
   e. Duration of the contract
   f. Maximum and minimum amounts of manure to be applied
   g. Whether the producer is under any obligation to continually provide manure during the term of the contract
   h. For producers of manure - a statement that there is no warranty with regard to the quality of the manure of what crops it should yield.
   i. For producers of produce - may want to specify nutrient standards. See National Hog Farmer's "Manure Agreements Cover Buyers, Sellers available at http://nationalhogfarmer.com/environmental-stewardship/0315-manure-hot-commodity (last visited July 7, 2015).

E. Livestock Leases

1. *Leases for Breeding Males*

a. Bull Leases

i. Pro
1) Using more genetic power and breed options
2) Conserving capital
3) Flexibility to change breed and traits

ii. Cons
1) Worry about disease more
2) Can be more expensive than owning them
3) Most bulls that are owned the owner is planning to use them for around 4-5 years See Beef Magazine's "Bull Leasing" available at http://beefmagazine.com/mag/beef_bull_leasing (last visited July 7, 2015).

iii. Cost of Leasing
1) Purchase price less salvage value divided by the number of years the animal was used

2) Additional costs:
    1. Annual interest on purchase price
    2. Maintenance costs for feed, pasture, mineral, supply and veterinary costs
    3. Premature loss from injury, infertility or death
    4. Annual fertility testing
    5. Loss of revenue from not having an additional cow (an additional calf can profit at least $100) See Profit Maker Bull's "Professional Cattleman's Bull Leasing Program" available at http://www.profitmakerbulls.com/bull-leasing-program.html (last visited July 7, 2015).

iv. Terms of a Bull Lease

1) A checklist of issues to address in a bull lease is available at Cari Rincker, "Checklist of Issues to Consider for Your Bull Lease," available at http://www.jdsupra.com/legalnews/checklist-of-issues-to-consider-for-your-50467/ (last visited July 11, 2015).

b. Stallion Leases

i. This is a good way to get a stallion that the owner is not willing to sell, and you can use the stallion just for the breeding season.

ii. When leasing a stallion for breeding, there are breed registries with their own forms and regulations. This is very important for foals.

1) A tale of caution: "There have been situations where a stallion was sold, the previous owner continued to stand the stallion at public stud taking the stud fees due for the stallion service; however, when it came take to register the foals, the new owner refused to sign the foal application forms because the stud fees collected were never forwarded to him by the previous owner." This expresses the importance of complying with registry practices, and the importance of written leases conforming to contract formalities as well. See Breeder's Corner's "Leasing a Stallion or Mare for Breeding" available at http://breederscorner.com/leasing.shtml (last visited July 7, 2015).

c. Ram Leases

i. The advantages to leasing a ram are similar to leasing other farm animals

1) Saving costs
2) Saving space

d. Boar Leases

2. ***Show Circuit Leases***

3. ***Livestock-Share Leases***

a. Advantages to the landowner
    i. Good for retired landowners who still want to maintain their business interest
    ii. Landowner can use past capital investments
    iii. Landowner shares work load and management
    iv. Livestock production is year round
    v. Flexibility in the operations and management

b. Disadvantages to the landowner
    i. Requires a great amount of operating and investment capital
    ii. Income is variable
    iii. Management is shared (this can be a pro or a con)

c. Advantages to the tenant
    i. Good for young farmers with limited capital
    ii. Risk is shared
    iii. Young farmers can learn a lot

d. Disadvantages to the tenant
    i. Responsibility for records and payment of bills
    ii. Determining how to share expenses and sales according to each person's contributions
    iii. Variable returns See North Central Regional Extension Publication 107 available at http://www.uwagec.org/farmmgt/PUBS/NCREPub107.pdf (last visited July 7, 2015)

4. ***Grazing Leases***

a. Rates typically mimic cattle and corn pricing

b. These rates are based on
    i. Current market rates
    ii. Return on investment in pastureland
    iii. Forage value
    iv. Rent per head per month

v. Carrying capacity
vi. Rent per pound of grain

See Iowa State University "Computing a Pasture Rental Rate" available at https://www.extension.iastate.edu/agdm/wholefarm/html/c2-23.html (last visited July 7, 2015).

IV. ADDITIONAL RESOURCES

CARI B. RINCKER AND PATRICK B. DILLON, FIELD MANUAL: LEGAL GUIDE FOR NEW YORK FARMERS' AND FOOD ENTREPRENEURS (2013), available for purchase at http://www.amazon.com/Field-Manual-Legal-Farmers-Entrepreneurs/dp/1484965191 (last visited February 25, 2014).

Donald J. Breece, "Farm Rental Agreement Checklist," The Ohio State University Extension FR-0003-01 available at http://ohioline.osu.edu/fr-fact/0003.html (last visited February 25, 2014).

Don Pershing and J.H. Atkinson, "Figuring Rent for Existing Farm Buildings" Publication No. EC-451 available at http://www.extension.purdue.edu/extmedia/EC/EC-451-W.html (last visited May 19, 2013).

Erin Herbold-Swalwell, "Legal Must-Know for Farm Lease Negotiations" at 3 National Business Institute webinar on "Farm Leases" (August 2013).

Iowa State University Cooperative Extension, "Improving Your Farm Lease Contract" File C2-01, FM 1564 (June 2011) available http://www.extension.iastate.edu/Publications/FM1564.pdf (last visited May 19, 2013).

Iowa State University Cooperative Extension, "Lease Alternatives for CRP Land" available at http://www.extension.iastate.edu/Publications/CRP2.pdf (last visited May 19, 2013).

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Jason Foscolo, "The Sustainable Lease Agreement, a Legal Tool for Land Stewardship," Cornell Small Farms Program available at http://smallfarms.cornell.edu/2013/01/07/the-sustainable-lease-agreement-a-legal-tool-for-land-stewardship (last visited July 11, 2013).

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K-State, "Kansas Agricultural Lease Law" C-668 (July 2005) available at http://www.ksre.ksu.edu/bookstore/pubs/c668.pdf (last visited February 25, 2014).

LeeAnn E. Moss and Bernie Erven, "Managing Landlord-Tenant Relationships: A Strategic Perspective" Publication FR-0004-01, available at http://ohioline.osu.edu/fr-fact/0004.html (last visited May 19, 2013).

National Agriculture Law Center's Reading Room for Agriculture Leases available at http://nationalaglawcenter.org/readingrooms/agleases/ (last visited May 19, 2013).

New York Farm Bureau, "Farmer's Guide to Oil & Gas Leases," available for purchase at http://www.nyfb.org/legal/NYFBs_Legal_Library_54_pg.htm (last visited July 17, 2013).

N.J. State Agriculture Development Committee, "Leasing Farmland in New Jersey: A Guide for Landowners and Farmers"

University of Nebraska-Lincoln Department of Agriculture Economics, "Farm Lease Calculator" available http://agecon.unl.edu/resource/farmcalc.html (last visited May 19, 2013).

Robert Fleming, "Tax Issues for Farm Rental Agreements," The Ohio State University Extension, FR-6-02 available at http://ohioline.osu.edu/fr-fact/0006.html (last visited March 11, 2014).

Rusty Rumley, "Agricultural Contracts and the Leasing of Land" available at http://nationalaglawcenter.org/assets/articles/rumley_contractsandleases-ppt.pdf (last visited May 19, 2013).

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U.S. Department of Agriculture, "Your Cash Farm Lease" Miscellaneous Publication No. 836 available at http://www.montana.edu/extensionecon/dynamicsinag/cashfarmleasepub836.pdf (last visited May 19, 2013).

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