Intro to Farmland Leases
Topics

- Land Lease Trends
- Communication
- Understanding & Maintaining the Productivity of Your Farm
- Types of Leases & Figuring a Fair Rent
- Legal Issues in Farm Leases
Why is it a Good Time to Look at Land Leases?

- **Price Volatility**
  - Both inputs and commodities

- **Land Market**
  - Land value (higher)
  - More rented land

- **More and more absentee or long distance landowners**
Leasing Indiana Farmland

• Percentage of leased farmland in Indiana is growing
  – 2012 – 53%
  – 2007 – 54%
  – 2002 – 52%
  – 1997 – 51%

Source: Census of Agriculture
Volatility

- Weather
- Commodity Prices
- Input Prices
Communication
Communication Establishes Trust

- Communication helps to create a good relationship between the landowner and tenant
  - It’s important...
    - Both parties clearly understand the terms of the lease.
    - Feel comfortable talking with one another.

Understand each other’s values and goals surrounding the land.
Written vs. Oral Communication

• Oral communication is important
  – Updates throughout the year
  – Maybe hand delivering rent check
  – Depends on agreement, landowner

• But written communication is crucial!
  – A written contract is a must, don’t rely solely on an oral agreement.
How Frequently Should You Communicate

- Depends on the landowner
  - Wants, availability
- Should at least be 2-3 times a year
- Communicate early and often
- Don’t leave issues unaddressed
End of the Year Report

- Crops planted
- Yields by crop or by crop and farm tract
- Notable production notes
- Land issues
- A brief description of plans for next year
- In the case of a crop share, a detailed summary of shared expenses
- In the case of a flexible lease, any components of the rent formula
Working with a New...

... Landowner

• Build a relationship
• Ask questions about the history of the land
• Ask about prior lease arrangement
• What are the landlord’s expectations?
• Check in more frequently

... Tenant

☐ Build a relationship
☐ Ask questions about tenant’s production practices
☐ State expectations
☐ Don’t be afraid to ask questions
Understanding & Maintaining the Productivity of Your Farm
Understanding & Maintaining the Productivity of Your Farm

• Several factors influence farm productivity
  – Rainfall
  – Drainage
  – Hybrid selection
  – Soil fertility and health
  – Good agronomic practices
Land is an Asset

• Like any asset-investments need to be made

• Productivity is proportional to investment
Nutrients Must be Maintained for Good Productivity

• Crops are heavy users of fertilizer, water, and sunlight
• Fertility and pH must be maintained at proper levels
• Crop usage better indicator than soil tests
Water Management is Key to Productivity

• Water is key to crop yields
• Supplement in dry weather
• Manage excess water through drainage
Soil Health and Fertility

- Good fertility
- Proper pH
- High organic matter
- Good soil structure
- Reduce compaction

All leads to greater productivity
Agronomic Practices

• Best practices lead to greater profit potential

• Water management and soil health best practices are very important

• Timely planting, harvesting, and pest management are key considerations

The Human Factor: How good is it?
What Is a Farm Worth in Rent?

- Opportunity cost
- Markets
- Land
  - Size
  - Quality of land
  - Ease to farm
  - Market forces
TYPES OF LEASES
Types of Leases

• Crop-share
• Cash
• Flexible cash
Types of Leases

CROP-SHARE LEASE
Crop-share Lease

- Tenant & landowner share some input costs
  - Seed, fertilizer, pesticides
- Tenant pays remaining operating costs
  - Machinery, labor, etc.
- Landowner pays land ownership costs
  - Real estate taxes, maintenance expenses, etc.
- Tenant receives a share of the crop as rent
- Price & yield risk shared
Crop-share Lease (% Share)

50-50 share
• Input costs shared equally between tenant & landowner
• Crop is shared equally

1/3-2/3 share
• Landowner pays 1/3 of input costs with tenant paying remaining 2/3
• Landowner receives 1/3 of crop with tenant receiving the remaining 2/3

May be variations in which costs are shared and which are not
Crop-share Lease

• Landowner advantages
  – Share in gains from high yields and/or high prices
  – Receive information about crop productivity
  – Direct benefit (via land productivity) from capital improvements such as tile or irrigation
  – Benefit from superior management ability of tenant
Crop-share Lease

- Tenant advantages
  - Risks due to low yields or prices are shared
  - Less operating capital “tied up”
  - Don’t need to finance cash rent payments
Crop-share Lease

• Landowner disadvantages
  – Income is variable
  – Must make marketing decisions
  – Often provides a lower return than a cash rent lease
  – More capital tied up than cash rent lease
  – Need to monitor accuracy of expense charges
  – Requires a high degree of trust in tenant
  – Lease needs to be reviewed for fairness as production methods change
Crop-share Lease

• Tenant Disadvantages
  – Profit from unexpected high yields or prices are shared
  – Requires keeping track of shared expenses
  – Lease needs to be reviewed for fairness as production methods change
  – Need to discuss annual cropping practices to make joint management decisions
Crop-share Lease

• Challenges
  – What is the correct share?
    • Varies with contribution, technology, cost of inputs, relationship
    • Is the return competitive to cash rent?
  – What items will be shared?
Types of Leases

CASH LEASE
Cash Lease

- Tenant pays all operating costs
- Landowner pays all land ownership costs
  - Real estate taxes, maintenance expenses, etc.
- Tenant receives entire crop & government payments
- Landowner receives a fixed rental amount
- Tenant takes all price & yield risk
Cash Lease

• Landowner advantages
  – Requires less managerial input
  – Reduces concern over accurate division of crops and expense
  – No worry about marketing crops
  – Lessens concerns over variations in prices and yields
Cash Lease

- Tenant advantages
  - Relative freedom in management decisions
  - Receive full benefit of your management skills and unexpected crop price increases and/or high yields
  - Eliminates division of crops or income from the sale of crops
  - Eliminates the need to keep track of crop expenses
Cash Lease

• Landowner disadvantages
  – Difficult to negotiate/renegotiate rental rate acceptable to both parties
  – Income could be less than crop share lease in some years
  – Potential for tenant to “mine” the land due to little or no landlord involvement
  – Potential for less production information shared by tenant
Cash Lease

• Tenant disadvantages
  – Higher risk - Cash rent becomes a fixed cash expense that may be difficult to pay in a poor crop year or with abnormally low prices
  – Cash rents tend to go up as crop yields increase
  – Higher capital costs
    • Pay all the crop production expenses
    • Pay cash rent – half at beginning of year, half at end of year
Cash Lease

• Challenges
  – What is the correct amount of rent?
    • Varies with grain price, yield, input costs, relationship
  – What is happening to fertility?
  – Is the landowner receiving adequate farm productivity information?
Cash Lease

- Establishing a Fixed Cash Rental Rate
  - Tenant’s residual
  - Landowner’s adjusted net-share from crop-share
  - Market approach
  - Return on investment
Cash Lease – Establishing Rental Rate

• Tenant’s residual
  – Estimate how much money is available for rent after variable and fixed costs

Gross revenue (crop sales & government payments)
- operating expenses
- machinery ownership costs
- drying & storage
- operator labor, management, & risk
= Return to land
<table>
<thead>
<tr>
<th></th>
<th>Corn</th>
<th>Soybeans</th>
</tr>
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<tr>
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<td>19</td>
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<td><strong>Operating Costs ($/ac.)</strong></td>
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<tr>
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<td>Dryer fuel</td>
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<tr>
<td>Machinery Fuel &amp; Repairs</td>
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<td>33</td>
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<td>Hauling</td>
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<td>5</td>
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<td>Interest</td>
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<td>7</td>
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<td>Insurance/misc.</td>
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<td><strong>Family &amp; Hired Labor</strong></td>
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<td><strong>Total Costs</strong></td>
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<td><strong>Return to land</strong></td>
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<td>$152</td>
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Cash Lease – Establishing Rental Rate

• Landowner’s adjusted share
  – Calculates an estimate of the landowner’s share under a crop-share lease to determine cash rent amount
    • Use 5-10 year yield average and current harvest time price for revenue estimate
    • Use current estimated crop production expenses
<table>
<thead>
<tr>
<th></th>
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<th>Soybeans</th>
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<tbody>
<tr>
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<tr>
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<td><strong>Total expenses paid by owner</strong></td>
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<td><strong>Net return to owner</strong></td>
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Cash Lease – Establishing Rental Rate

• Market approach
  – Rental rate based on current rents in the area
  – Often difficult to obtain a “going rate”
  – “Going rate” does not apply to every situation
  – Potential sources include:
    – Purdue Land Value & Cash Rent Report
    – NASS Cash Rent Values
    – Word of mouth
Table 2. Average estimated Indiana cash rent per acre, (tillable, bare land) 2013 and 2014, Purdue Land Value Survey, June 2014

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<thead>
<tr>
<th>Area</th>
<th>Land Class</th>
<th>Corn bu/A</th>
<th>Rent/Acre 2013</th>
<th>Rent/Acre 2014</th>
<th>Change '13-'14</th>
<th>Rent/bu. of Corn 2013</th>
<th>Rent/bu. of Corn 2014</th>
<th>Rent as % of June Land Value 2013</th>
<th>Rent as % of June Land Value 2014</th>
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<td>297</td>
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<td>1.53</td>
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<td>1.41</td>
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<td>165</td>
<td>166</td>
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<tr>
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## COUNTY CASH RENTS, INDIANA, 2010

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<th>Cropland Rent</th>
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2010 County Level Cash Rents,
USDA/NASS
Cash Lease – Establishing Rental Rate

- Return on investment
  - Multiply estimated current market value of land by expected rate of return
  - Recent cash rent surveys indicate cash rents average 3-4% of market value
  - Imprecise but establishes a range
### 2014 Purdue Land Value and Cash Rent Survey

#### Indiana

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<thead>
<tr>
<th>Land Values</th>
<th>Cash Rent</th>
<th>Percent</th>
</tr>
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<tr>
<td>Top</td>
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<td>Top 292</td>
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<tr>
<td>Ave</td>
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<tr>
<td>Poor</td>
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<td>Poor 179</td>
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<tr>
<td></td>
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#### Southwest IN

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#### Land Value and Rate of Return

<table>
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<th>Land Value</th>
<th>Rate of return</th>
<th>Estimated rental range</th>
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<td>7500</td>
<td>2.90% 3.00% 3.20%</td>
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Purdue University is an equal access/equal opportunity institution
Now What??

<table>
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<tr>
<th>Tenant's Residual</th>
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Negotiate, negotiate, negotiate…….
Types of Leases

FLEXIBLE CASH LEASE
Flexible Cash Lease

• Tenant pays all operating costs
• Landowner pays all land ownership costs
  – Real estate taxes, maintenance expenses, etc.
• Tenant receives entire crop & government payments
• Rent amount varies based on price, yield, or gross revenue, etc.
Flexible Cash Lease

- Advantages & Disadvantages
  - More complicated than fixed cash lease
  - Net income varies for both tenant & landowner
  - Performance depends on terms of lease
    - Base rent
    - Operators guarantee
    - Amount of adjustments above minimum rent
  - Requires careful monitoring
Flexible Cash Lease

• Types of Flexible Leases
  – Percentage of Gross Revenue
  – Base Rent plus Bonus
  – Base Adjusted for Price
  – Base Adjusted for Yield
  – Base Adjusted for Price & Yield
Flexible Cash Lease

• Percentage of Gross Revenue
  – Rent amount set at a percentage of gross revenue, usually 25-40%
  – Gross revenue calculated by multiplying actual harvested yield by cash market price
  – Similar to crop share lease without division of costs or harvested crop
Flexible Cash Lease

• Base Rent plus Bonus
  – A minimum base rent is set, to which a share of revenue above a certain base gross revenue value may be added
  – Minimum base rent should be set lower than a typical fixed cash rent amount
  – Base gross revenue could equal revenue under typical conditions or tenant’s cost of production (including base rent)
Flexible Cash Lease

- Base Adjusted for Price and/or Yield
  - A base rent is set and adjusted based on the price and/or yield of the crop
  - Leases adjusted for only price or only yield may increase tenant’s risk
  - If base rent is a minimum rent, it should be set lower than a typical fixed cash lease rate
Flexible Cash Lease

• Challenges
  – How is a base rent amount determined?
  – What share of gross revenue is used?
  – What is the source of price and yield information?
    • County or farm data
    • When is the data collected?
Legal Issues in Farm Leases

Presenter:
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Duration of a lease

ORAL OR WRITTEN LEASE
Oral Leases

• Oral leases are binding in Indiana
• Advantage: No paperwork
• Disadvantage: Bad memories
• Today’s Farming practices are too complicated to leave to memory

Put it in Writing!
Does requesting a written lease signal a lack of trust?

Absolutely not!
Benefits of a written lease

• It documents the terms of your agreement and provides a basis for avoiding or settling misunderstandings.
• It is an effective antidote for forgetfulness and the passage of time which can alter contracting parties understanding of agreements first entered into perhaps years ago.
• It forces the contracting parties to consider legal and practical issues that otherwise can easily be overlooked. In that way it is a useful planning tool.
Duration of Lease

• **Annual or Multi-year Lease**
  – More than 3 years – MUST be in writing
  – Any lease should be *recorded* at Recorder’s Office
    • Protects tenant’s rights against transfer of land
    • Puts tenant’s rights ahead of creditors
  – Annual leases that automatically renew don’t have to be recorded every year (first time is enough)
Recording a Lease

- Recorded (Memorandum of) Lease must contain:
  - Name and address of Landlord
  - Name and address of Tenant
  - Term of Lease
  - Legal description

- You do not have to record the full lease
What Should Be Covered in a Lease?

ELEMENTS OF A LEASE AGREEMENT
Elements of a Farm Lease

• The full and legal names and addresses of the parties and their marital status
• A full and correct legal description of the property
  – Identify Tillable and Non-Tillable Acres
• When the lease starts
• When the lease ends
• The date of making the lease
• Amount and terms of payment
• The landlord and tenant share of costs and crops
• Resource contributions of landlord and tenant
Elements of a Farm Lease (con’t)

- Provisions for re-imbursement of unrecovered investments in improvements, growing crops, and inputs made by tenant.
- An exit plan at end of lease
- Termination of lease other than at expiration of lease
- Allowed uses of the leased land
- Whether use of improvements (barns, bins) is included
- Allowed and required farming and conservation practices
Elements of a Farm Lease (con’t)

- Maintaining fertility & controlling weeds
- Removing crop residues
- Participating in government programs
- Participation in crop insurance
- Maintaining & using facilities, improvements, & drainage
- Tenant’s obligation to furnish production records
Elements of a Lease: Plan for Changes

- Long-running landlord-tenant relationships must be able to adapt to a changing farm economy
- Include provisions for amending the lease
  - Any amendments should be in writing and signed by both parties.
- Include provisions for resolving disputes
- Include a timeline or plan for renegotiating rents
Elements of a Lease: Other legal matters

- A statement that the lease arrangement is not a partnership
- Signatures of remainder persons if landlord is a life tenant
- Provision requiring tenant to provide adequate liability insurance coverage that specifically protects landowner
- Indemnification Language
- Provision protecting landlord in the event that farming causes environmental damages
- Provision limiting tenant’s right to sublease the land without landowner permission
Elements of a Lease: Other legal matters

- Lease must be signed by both parties
- Lease must be dated
- If recorded - lease must be notarized
- If more than one year – lease must be notarized
- If landlord is out of area – lease should be notarized
- What about Evergreen Leases?
Talk to an Attorney

• It is a good investment to protect yourself, the other parties to the lease agreement, and your family.

• It is good business practice and an even better risk management strategy.

• *More money at stake makes more disputes inevitable.*

• Legal issues related to farmland leasing don’t end with the lease agreement itself.
Tenants

RIGHTS AND RESPONSIBILITIES
Tenant R&R
(Rights and Responsibilities)

• **Rights of Tenants**
  – Right determine how land is used
    • When to plant, what to plant, when to harvest
  – Rights to government payments
  – Right to growing crops (mostly)
    • *Doctrine of Emblements*
  – Right to continue year-to-year, if not otherwise terminated
Tenant R&R
(Rights and Responsibilities)

- *Tenant Responsibilities*
  - Not to “commit waste”
    - Removal of noxious weeds
    - Preservation of ditches, watercourses, watersheds
  - To maintain fertility
  - To pay rent (or provide crop share)
Landlord R&R
(Rights and Responsibilities)

• **Landlord Rights**
  – Payment of Rent
    • UCC Lien on crops
  – Right to preservation of land
  – Right to preservation of fertility
Landlord R&R
(Rights and Responsibilities)

• **Landlord Responsibilities**
  – Cannot sell land in violation of Tenant rights
  – Allow Tenant “quiet enjoyment” of land
  – Payment of property taxes
Other Rights and Responsibilities

• Who pays for lime (long-term fertility)
  – Sliding reimbursement for early termination of lease

• Who makes repairs (buildings, fences, ditches)
  – Major repairs
  – Minor repairs
  – Mowing roadsides, general weed control

• Fence rows and trees

• Hunting, Fishing, Boating
Other Rights and Responsibilities

• Access to the Field
  – Off the road, use of easement
  – Storing equipment

• Third parties – who controls/enforces?
  – Recreational users
  – Mineral rights and leases
  – Wind Turbines – Cell Towers
  – Easements and Cemeteries
    • Access Easements
    • Conservation Easements
Issues and Concerns

WHEN LEASES GO WRONG
When Leases Go Wrong

• Oral lease for a term > 3 years
• Any lease that is not recorded
• When LL sells the land
  – What are the Tenant’s Rights?
• When LL is bankrupt
  – What are the Tenant’s Rights?
When Leases Go Wrong

• Failure to include termination or notice due dates
  – Confusion as to whether the lease will continue for another year
  – Legal notice by December 1

• It’s the Tenant’s responsibility to make sure his rights are protected *(aka – Get it in Writing!)*
What Happens at the End of a Lease?

TERMINATION OF LEASES
When Leases End - Termination

**Termination provisions**

- Notice must be given > 3 months before end of lease

  - UNLESS – Lease is for a specific term, the tenant commits waste, tenant refuses to pay, tenant is at sufferance

**Failure to give notice timely** =

- NO Termination
Good Landlord-Tenant Relationships

PRESERVING THE RELATIONSHIP
Lease Tips

• Don’t let a farm lease get “stale”
  – Maintain regular contact with LL/T
  – Foster a good and friendly relationship
  – Discuss rent arrangement at least annually

• Provide documentation
  – 1099 for rent payments (individuals only)
  – Fertility/Soil Test records
  – Productivity Records
Lease Tips

• **Provide Education to Landlord**
  – Landlords may be far removed from the farm and not understand customary practices
  – Landlords may not understand that different farms have different values for rent and different challenges for farming

• Good relationships +

• Good communications =

• **Long-Term and Profitable Leases**
Summary – Legal Leases

- Written
- Type
- Terms
- Termination
- Payment
- LL Rights
- T Rights
Conclusion

• Common sense
• Staying informed
• Following good business practices
• Communicating
• Investing in competent advice

Will greatly increase the sense of security and satisfaction of all parties to farmland leases.
More Resources

• More information and sample lease forms available at North Central Farm Management Extension Committee website:

  http://AgLease101.org

• Purdue Extension Land Lease Website

  www.agecon.purdue.edu

• Iowa State Ag Decision Maker Website

  www.extension.iastate.edu/agdm
Questions? Answers?

Thank you for your attention

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