

Farm Leases

by *Christine E. Nicholas, Moffatt Thomas*

According to the National Agriculture Statistics Service, in 2012, Idaho had 1,698 tenants on 931,420 acres of farmland, compared to 1,553 tenants on 834,383 acres of farmland in 2007. The increased in rented farmland does not appear to have come at the expense of a decrease in owned farmland, however. While full owners decreased from 2007 to 2012, part owners increased, and both land farmed by full owners and land farmed by part owners increased from 2007 to 2012.¹ All of these increases are probably a reflection of the improved farm economy from 2007 to 2012.

These materials will explore lease basics, types of farm leases and their relative advantages and disadvantages, and how to prepare a strong farm lease.

Lease Basics

A lease is an agreement by which a landowner transfers real property rights to another – the rights generally consist of the right to exclusive occupancy of the subject real property for the purposes and on the terms agreed to between the parties. Idaho's statute of frauds requires that a lease for a term of more than one year be in writing in order to be legally enforceable.² Of

¹ See, Table 45. Selected Operation and Operator Characteristics: 2012 and 2007, USDA Census of Agriculture, 2012, Census Vol.1, Ch. 2: State Level Data, available here:

http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_2_US_State_Level/

² Idaho Code Section 9-503: "TRANSFERS OF REAL PROPERTY TO BE IN WRITING. No estate or interest in real property, other than for leases for a term not exceeding one (1) year, nor any trust or power over or concerning it, or in any manner relating thereto, can be created, granted, assigned, surrendered, or declared, otherwise than by operation of law, or a conveyance or other instrument in writing, subscribed by the party creating, granting, assigning, surrendering or declaring the same, or by his lawful agent thereunto authorized by writing."

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These materials were prepared in October 2015 and are intended as an information source for clients and friends of Moffatt Thomas. The content should not be construed as legal advice in particular circumstances, and readers should not act upon information in this publication without professional counsel. Christine can be reached at (208) 345-2000 or cen@moffatt.com.

course, it is advisable for all leases to be in writing to minimize disputes over the terms of the lease agreement and simplify any action that might be taken to enforce the terms of the lease.

A lease should describe the parties to the lease (landlord and tenant), the legal description of the property being leased, the length of the lease, the rent to be paid (what, how, when, where), what the tenant must do, what the tenant may do, and what the tenant cannot do, what happens if the tenant fails to perform the lease, what condition the land must be in when the lease ends, what things the tenant has to do to take care of the property during the lease, and so on.

Types of Farm Leases

The four most common types of farm leases are the fixed cash lease, the flexible cash lease, the crop-share lease, and the custom farming contract. The common terms of these agreements are described as follows:

Fixed Cash Lease

- Under a fixed cash lease the tenant pays a given amount of cash rent per acre per year for the use of the farm resources.
- The landlord may put some restrictions on what crops can be grown, or what tillage, conservation and pest control practices can be used. Other than this, the tenant has a free rein in planning the crop and livestock production program on the farm unit, and receives all the crop and any USDA commodity program payments.

Flexible Cash Lease

- A variation of the fixed cash lease is a flexible lease, in which the actual rent to be paid depends on the actual yields attained and the selling prices available during the lease period. This ensures that the rent paid is in line with the profitability of the crops grown that year.
 - the landlord might receive cash rent equal to a specified share of the gross revenue of the tenant's crop determined following harvest
 - the landlord might receive a base rent plus a percentage of gross or net revenue in excess of the base rent
- Sometimes government payments and crop insurance benefits are also included in calculating the gross revenue. The landowner shares some of the risk of low yields or declining prices, but also shares in the extra profits when prices and/or production exceed expectations.
- Some flexible leases also take into account crop input costs when determining the final rent or bonus.

Crop-share Lease

- The distinguishing characteristic of a crop-share lease is that the owner receives a share of the crop and USDA payments as a return for the land resources used, but no cash payment.
- There may be a separate rental charge for a set of buildings or crop storage facilities.
- The owner normally furnishes land and buildings and pays half of the costs of inputs such as fertilizer, seed, and pesticides when the crop is divided 50-50. Owners are usually responsible for drying, storing and marketing their share of the crop, as well. The tenant usually furnishes all the labor, fuel, equipment, and the other half of the shared expenses. Many variations on sharing of expenses exist, however.

Custom Farming Contract

- Under a custom farming contract, the operator supplies all the labor and equipment needed to perform tillage, planting, pest control, harvesting and storing of crops. The landowner pays all other expenses, and receives all the crop and USDA payments.
- The custom operator receives a fixed payment per acre from the owner, or a fixed payment for each operation performed.
- Some agreements pay the custom operator a bonus for meeting certain planting date or yield goals. Others provide for the operator to receive a percentage of the crop instead of a cash payment, generally from 20 to 25 percent. This is sometimes referred to as a "net share lease." If the custom operator takes responsibility for purchasing and delivering crop inputs, the cash payment or share of the crop is generally higher.

Livestock can be leased, too, but these materials address land leases and not livestock lease arrangements.³

³ From a rancher's perspective, leasing cows can be an alternative to financing herd expansion. A cow leasing or sharing arrangement allows two business partners to share the production costs and, in turn, the cowherd income. An equitable agreement is one where the two parties share the calf crop in the same proportions that they share the production costs. If the cow owner provides 25% of the production costs of operating the beef cowherd, and the working rancher provides the remaining 75%, then an equitable deal would be for the beef cow owner to get 25% of the calf crop and the working rancher to get the remaining 75% of the calf crop. In a beef cow share agreement, production expenses can be shared in many different ways as long as the calf crop is shared in the same proportion as the expenses. Typically, the cow owner provides the cows and the replacement heifers, while the participating rancher provides the rest of the resources. Whoever owns the bulls gets the cull bull income, which should be negotiated and specified as part of the initial written business agreement. Often, the cow owner wants to provide the bulls in order to control the calves' genetics.

Advantages/Disadvantages of Different Types of Farm Leases

All types of leases have advantages and disadvantages to each party. The tenant and owner should consider them before choosing the type of lease and the terms that should be incorporated in it.

Fixed Cash Lease

Advantages:

- The lease is simple with relatively few chances for misunderstanding.
- The owner is relieved of making day-to-day operating decisions.
- The owner has very little financial risk.
- The tenant has maximum freedom in planning and developing the cropping and livestock programs.
- The tenant has fewer records to keep when multiple landlords are involved.

Disadvantages:

- A fair cash rental rate may have to be renegotiated each year.
- Cash rents are likely to be too low in times of rising prices and increasing yields, and too high in times of low prices or low yields.
- Selling prices and production costs may be higher or lower than anticipated when the rental rate is set.
- Tenants are required to supply more operating capital.
- Tenants bear all the risk of production shortfalls.

Flexible Cash Lease

Advantages:

- The amount of rent to pay increases or decreases automatically from year-to-year as prices and yields change.
- The need for the owner and tenant to renegotiate the rental rate each year is significantly reduced.

Disadvantages:

- Both parties must agree on a formula or method for setting the cash rent each year.
- Both parties must agree on how to determine the prices and yields to include in the formula.
- There is uncertainty about how much the tenant will pay and the owner will receive each year.

Crop-share Lease

Advantages:

- Risks associated with price and yield variations are shared.
- The owner is more involved in making decisions and marketing the crop during the year.
- Both parties share the benefits from adoption of yield-increasing technology, or unexpected high yields or prices.
- The owner receives more information about yields and inputs used each year.
- A second USDA payment limit is created.

Disadvantages:

- The landlord and tenant must agree on how production expenses will be shared.
- Adjustments for sharing costs for storage and drying facilities, herbicides that reduce field work, or fertilizer and pesticide application may have to be made.
- The cropping plan to be followed and whether or not the farm participates in government programs must be agreed on.
- Added cash rent for the use of buildings and storage facilities may have to be negotiated.
- If the owner's and tenant's grain is stored in the same bin, marketing decisions have to be made jointly.
- The landowner may be considered a material participant, and farm income will be subject to self-employment taxation.

Custom Farming Contract

Advantages:

- There is very little financial risk for the operator.
- The owner benefits from any unexpected high prices, yields or government program payments.
- Only one party is responsible for marketing grain and making production decisions.
- Agreements are usually fairly simple to negotiate.

Disadvantages:

- The owner bears all the risk of low yields or prices, or high input costs.
- The number and timing of field operations to be done each year may have to be modified, depending on weather conditions.
- The operator has to set priorities among the custom farmed land and other rented or owned land.
- The owner must communicate to the custom operator the cropping system, fertility program, and type of pest control to be used.
- Crop inputs such as seed, fertilizer and pesticides must be purchased and delivered in a timely manner.
- The landowner may be considered a material participant, and farm income could be subject to self-employment taxation.

How to Draft a Strong Farm Lease for Your Clients

1. Have a clear understanding of the business terms of the lease (for example, will the landlord reserve some right to the land, such as hunting rights? If the tenant's occupancy will not be exclusive, the lease needs to spell that out).
2. Understand what the condition of the farm ground will be when the lease takes effect – will ground prep work have taken place? will crop be in the ground?
3. Enter into a written lease agreement with clearly articulated terms.
4. If there are any restrictions on use of the land (where water can be applied, how much water can be used, what kinds of chemicals can be used, etc.) make sure the lease clearly states the restrictions or limitations.
5. Understand whether government program payments are in play and how they'll work.
6. If you want an alternative dispute mechanism (mediation or arbitration), make sure the lease contains clear provisions direction how disputes will be resolved.

A checklist, such as the following, can be a helpful negotiating and drafting tool:

Parties to Lease and Description

- ___ Date the lease is entered into.
- ___ Name and addresses of the landlord and tenant.
- ___ Legal description of the leased property.
- ___ Description of water rights, if any, that are leased with the real property.
- ___ Signatures of the landlord and tenant.

General Terms

- ___ Time period of the lease, including beginning and ending dates.
- ___ Rental amount for cash lease; respective shares and contributions if a crop-share lease.
- ___ When and how rent will be paid and penalties for late payments.
- ___ Who will carry insurance on the property and the crop.
- ___ Statement that the landlord and tenant do not intend to create a partnership by entering into the agreement. Neither party will obligate the other for debts/liabilities or damages.
- ___ Conditions under which the tenant may or may not sub-lease the property.

Termination

- ___ When and how the lease may be terminated and requirements for notice of termination.
- ___ Reimbursement provisions for crop nutrients, lime and/or completed fieldwork upon termination of the lease.
- ___ Acts of the tenant that would constitute default of the lease.
- ___ Tenant's rights if the property is transferred or condemned during the lease period.

___ Reimbursement provisions for a crop still in the ground when the lease is terminated.

Operation and Maintenance

___ Desired or prohibited farming practices, including types of chemicals that may not be used on the property.

___ Process of measuring and maintaining soil fertility and pH levels.

___ Which party is responsible for controlling noxious weeds.

___ Which party is responsible for maintaining fences.

___ Whether the tenant has the right to make improvements and be compensated for improvements.

___ Whether the tenant has the right to utilize improvements made by the landlord.

___ Provisions for soil-conservation practices.

___ Statement regarding the existing environmental status of the property and responsibility to minimize activities that may cause contamination.

___ Use of non-cropland, garden plots, trees, buildings, grain bins, pasture or other areas not rented for cropland.

Landlord Rights and Government Payment

___ Landlord's right to enter the property for specific purposes (hunting, fishing, gleaning, etc.).

___ Landlord's right to a security interest in the crops or other provisions for ensuring payment.

___ Statement of which party will participate in federal farm programs, including responsibility for eligibility and receipt of payments.

___ Nature of landlord participation in management. This may relate to issues regarding income and self-employment, taxes, social security payments, and estate planning.

Resolution of Differences

___ Provision that any amendments must be in writing and signed by both parties.

___ Procedure for resolving disputes – litigation, arbitration, mediation? where? before what body? -- including the applicable state statutes.

Crop-Share Provisions

___ General agreement, sharing of crops and tenant's contribution of machinery and labor. Each party should share returns in the same proportion as resources are contributed.

___ Sharing of operating expenses, generally variable expenses are shared in the same percentage as the crop share; if there are adjustments for no-till, custom application, liming or any new technologies adopted.

___ Storage and/or delivery of landlords share of crops.

___ Compensation upon termination of the lease.

___ What records are to be kept by whom and how will this information be shared.

Attached to the **Appendix** are some USDA farm lease forms⁴ and a suggested custom farming contract template from Iowa State's Extension Office, for illustrative purposes.

Idaho Case Law Construing Farm Leases

Idaho case law construing farm leases construe them the same as other contracts:

Steel Farms v. Croft & Reed, 154 Idaho 259, 297 P.3d 222 (2012) involved an action by the lessee of farm ground to enforce a purchase option in a farm lease and a determination of the ownership of irrigation equipment. The Supreme Court applied traditional concepts of contract interpretation:

- a court will enforce the language of a contract where the language is plain and unambiguous
 - for a contract to be ambiguous, there must be at least 2 different reasonable interpretations of the term, or the term must be nonsensical
- the plain language of a contract, if unambiguous, is controlling
 - but if an ambiguity exists, parol evidence may be considered by the trial court to determine the intent of the drafter
- a court must look to the contract as a whole and give effect to every part of it
- an agreement may be modified by handwritten interlineation
 - in this case, the court held that a merger clause in the lease did not require the amendment be contained in an instrument physically separate from the original lease and could be accomplished by interlineation within the original instrument
- a written contract containing a merger clause is integrated for purposes of the parol evidence rule
 - parol evidence is admissible to establish any fact that does not vary, alter, or contradict the terms of the contract or the legal effect of the terms used
 - particularly interesting part of this decision is the court's determination on the nature of the irrigation equipment as fixtures or personal property:
 - the court notes that irrigation equipment and fixtures are not mentioned anywhere in the lease, so parol evidence was acceptable

⁴ The forms are no longer in USDA's e-forms system, but are available at <http://forms.sc.egov.usda.gov/efcommon/eFileServices/Forms/FSA1940-0053.pdf> and <http://forms.sc.egov.usda.gov/efcommon/eFileServices/Forms/FSA1940-0051.pdf>

to determine whether the parties intended the irrigation equipment to be fixtures,

- court provides further guidance on the 1984 *Rayl*⁵ decision whether property constitutes a fixture is a mixed question of law and fact determined by the application of 3 tests: (1) annexation to the realty, (2) adaptation or application to the use or purposes of that part of the realty to which it is connected, and (3) intention to make the attached article a permanent accession to the land
- “[O]ur holding in *Rayl* was narrowly tailored to the unique facts of that case and does not mandate that irrigation equipment must always, as a matter of law, be a fixture” and courts must always assess the objective intent, annexation and adaptation to determine whether the fixture tests are satisfied.

Corder v. Idaho Farmway, 133 Idaho 353, 986 P.2d 1019 (App. 1999) involved an action by the tenant of farm ground for breach of lease. The parties exchanged a fax of a draft of the lease agreement but never signed the lease. The draft lease agreement provided for a term of 5 years, required annual rent be paid in 2 installments, and imposed obligations on the landlord to provide water and provide, repair and maintain certain irrigation facilities. The Court of Appeals found the oral lease enforceable under the part-performance exception to the statute of frauds:

- an oral agreement for the sale or lease of property is enforceable if partially performed
 - in this case, part performance was demonstrated by the tenant’s installment payment, the tenant taking possession of the land, planting and harvesting spring crops in 1995 and preparing the ground in the fall of 1995 for the following year’s crops

for a contract to be ambiguous, there must be at least 2 different reasonable

Grazing Leases.

Ranchers may lease public or private land to graze cattle or sheep. A recent study by the University of Idaho College of Agricultural and Life Sciences⁶ indicates that private rangeland grazing leases are generally informal, year-to-year arrangements, with terms negotiated on an annual basis. The bulk of Idaho’s grazing leases on native rangelands are season-long or require a rotational grazing program during the grazing season (1-6 months). Most of the leases were cow-calf productions. The average rate charged for private grazing leases in 2011 was \$16.04/AUM (as compared to the USDA-NASS rate of \$14.50/AUM). Rate variability differed widely region to region, and whether the landowner provided any services affected the lease rate. For the leases in the research survey, when the landowner provided daily livestock care, lease

⁵ *Rayl v. Shull Enterprises*, 108 Idaho 524, 700 P.2d 567 (1984).

⁶ University of Idaho College of Agricultural and Life Sciences Research Bulletin 185 (Aug 2014).

rates increased by \$2.20/AUM (or 20%). Leases with yearling cattle and irrigated land also carried higher lease rates.

Leases in the research survey were paid on a \$/head or lump sum basis, with most leases requiring payment after the grazing season or split between pre-and post-grazing. While not addressed in the U of I study, in the author's experience, there are three main options available in regards to rental charges:

- Flat fee per acre or as a whole unit. This option does not take into account the number of cattle that graze the land during the grazing season. Rental payments may be paid after the grazing season or divided into monthly payments.
- Rental fee per head per month. With this payment option, a rental charge per month is applied to each animal. Payments can be made monthly or once following the grazing season.
- Other arrangements. Some producers that lease grazing land for yearling cattle pay rent based on pounds gained per day. For example, let's say the rental charge is 40 cents per pound gained.

Good drafting principles are common to both private grazing leases and farm leases: the leases should be in writing and clearly set forth the economic terms, any restrictions on use (such as limitation on the number of head or other ways to prevent over grazing), and the parties rights and remedies in case one of them fails to perform.

APPENDIX

See attached.

FSA-1940-53
(06-11-02)

U.S. DEPARTMENT OF AGRICULTURE
Farm Service Agency

CASH FARM LEASE

(See Page 7 for Privacy Act and Public Burden Statements.)

THIS LEASE is entered into this (1) _____ day of (2) _____, 20 (3) _____

between (4) _____, landlord, of (5) _____
(Address of Landlord)

and (6) _____, tenant, of (7) _____
(Address of Tenant)

A. PROPERTY RIGHTS. The landlord hereby leases to the tenant, to occupy and use for agricultural and related purposes, the following-

described property, hereinafter referred to as the "farm," located in (8) _____

County, State of (9) _____, and commonly known as the (10) _____

farm: (11) _____

and consisting of (12) _____ acres, more or less, together with all buildings and improvements thereon and all rights thereto except as specified below:

1. **Right of entry.** The landlord reserves the right to enter the farm at any reasonable time for purposes (a) of consultation with the tenant; (b) of making repairs, improvements, and inspections; (c) of developing mineral resources; and (d) after notice of termination of the lease is given, of plowing, seeding, fertilizing, and such customary seasonal work, none of which is to interfere with the tenant in carrying out regular farm operations. This right is also reserved to the landlord's agents, employees, and assigns.
2. **Transfer of farm.** If the landlord should sell or otherwise transfer title to the farm, such sale or transfer will be subject to the provisions of this lease.
3. **Heirs and successors.** The terms of this lease shall be binding upon the heirs, executors, administrators, and successors of both landlord and tenant in like manner as upon the original parties. However, in the event the lease is for more than one year, the heirs or successors of the tenant shall have the option to give written notice of termination effective at the end of the lease year in which death occurs.
4. **Right to lease.** The landlord has the right to lease the farm, and so warrants to the tenant. Further the landlord will defend the tenant's possession against any and all persons whomsoever.

5. **Additional agreements regarding property rights:** (13) _____

B. LAND USE AND LIVESTOCK PRODUCTION.

1. **Land use and kind of livestock.** Except when mutually agreed otherwise, the land use and cropping plan shall be as follows and the numbers of each kind of livestock shall not exceed those shown in the following table:

LAND USE AND LIVESTOCK PRODUCTION TABLE

(14) USE OF LAND	(15) ACRES	(16) FIELDS	(17) KIND OF LIVESTOCK	(18) MAXIMUM NUMBERS
(19) TOTAL				

2. **Acres and numbers.** The acres of crops and the fields on which grown and the numbers of livestock shown above are those planned for the first year of this lease. They may be adjusted within the year or from year to year by mutual agreement.

C. IMPROVING, CONSERVING, AND MAINTAINING THE FARM. To improve the farm, conserve its resources, and maintain it in a high state of cultivation, the two parties agree as follows:

- 1. **General maintenance.** The tenant will maintain the farm during the tenancy in as good condition as at the beginning, normal wear and depreciation and damage from causes beyond the tenant's control excepted.
- 2. **Good husbandry.** The tenant will operate the farm in an efficient and husbandlike way, will do the plowing, seeding, cultivating, and harvesting in a manner that will conserve the landlord's property.
- 3. **Cropping practices.** The tenant will *not*, without oral consent of the landlord, (a) plow permanent pasture or meadowland, (b) cut live trees for sale or personal uses, but will take for fuel or use on the farm only dead or unmarketable timber designated by the landlord, (c) allow livestock other than the tenant's own on stalkfields or stubblefields, (d) burn or remove cornstalks, corncoobs, straw, or other crop residues grown on the farm, (e) pasture new seedings of legumes or grasses in the year they are seeded, and (f) plant legumes on land not known to be thoroughly inoculated without first inoculating the seed.
- 4. **Manure and crop residue.** The tenant will spread the manure straw, or other crop residues on the farm as soon as practicable on fields agreed upon by the two parties, except as follows: (20) _____

- 5. **Pasturing.** The tenant will prevent tramping of fields by stock and rooting by hogs when injury to the farm will be done.
- 6. **Waste.** The tenant will not commit waste on, or damage to, the farm and will use due care to prevent others from so doing.
- 7. **Fire protection.** The tenant will not, without written consent of the landlord, house automobiles, motortrucks, or tractors in barns, or otherwise violate restrictions in the landlord's insurance policy which restrictions the landlord shall make known to the tenant.
- 8. **Replace losses.** The landlord will replace or repair as promptly as possible the dwelling or any other building that may be destroyed or damaged by fire, flood, or other cause beyond the control of the tenant or make rental adjustments in lieu of replacements.
- 9. **Noxious weeds.** The tenant will use diligence to prevent noxious weeds from going to seed on the farm and will destroy the same, and will keep the weeds and grass cut or destroyed on the fields, farmstead, roadside, and fence rows. Treatment of weed infestation and cost thereof, shall be handled as follows: (21) _____

2. **Variations for price (for method 2).** The prices to be used in Column (45) will be determined as follows: (47) _____

3. **Variations for production conditions.** The total amount of rent for the entire farm as shown in either Column 4 or as calculated for Column 9 shall be adjusted for any year in which the yield of (48) _____ as reported by the State Crop Reporting Service is (49) _____ percent above or below the county average yield for the previous (50) _____ years, as follows: (51) _____

4. **Rental payment.** The annual rental due shall be paid as follows: (52) \$ _____ on (53) _____ and (54) \$ _____ on (55) _____, and the payments shall be made at (56) _____

5. **Additional agreements in regard to rental rates:**

(57) _____

6. **Expenses:** Expenses shall be supplied by the tenant except as included in Section C and except as follows:

EXPENSES

(58) EXPENSES	(59) FURNISHED BY LANDLORD \$	(60) EXPENSES	(61) FURNISHED BY LANDLORD \$	(62) EXPENSES	(63) FURNISHED BY LANDLORD \$
LABOR		CROP EXPENSES		ELECTRICITY	
MAINTENANCE-BUILDINGS				TELEPHONE	
MAINTENANCE-FENCES		SEED		INSURANCE--BUILDINGS	
MACHINE REPAIRS				INSURANCE-CROPS	
FUEL-TRACTOR		INSECTICIDES			
FUEL-TRUCK		WEED CONTROL MATERIAL			
FUEL-OTHER		LIMING MATERIAL		TAXES-REAL ESTATE	
CUSTOM WORK AND HAULING		FERTILIZER		TAXES -PERSONAL	
FEED PURCHASED OR SUPPLIED					
LIVESTOCK EXPENSES					

7. **Record of expenses.** The tenant will keep a record of expenses furnished by the landlord, and settlement will be made by mutual agreement or at the time that final rent payment is due.

8. **Additional agreements relative to expenses:** (64) _____

E. TERM OF LEASE

1. **Term.** The term of this lease shall be (65) _____ year(s) from (66) _____, 20 (67) _____ to (68) _____, 20 (69) _____ and this lease shall continue in effect from year to year thereafter until written notice of termination is given by either party to the other at least (70) _____ months before expiration of this lease or any renewal.

2. **Continuous occupancy.** The farm will be possessed and occupied continuously during the term of the lease by the tenant or the tenant's agent.

3. **Surrender of possession.** The tenant agrees to surrender possession and occupancy of the premises peaceably at the termination of the lease.

4. **Review of lease.** A request for general review of the lease may be made at least (71) _____ days prior to the final date for giving notice to terminate this lease. Amendments and alterations to this lease shall be made in writing.

F. MISCELLANEOUS PROVISIONS

1. **No partnership created.** This lease shall not be deemed to give rise to a partnership relation, and neither party shall have authority to obligate the other without written consent, except as specifically provided in this lease.

2. **Government programs.** The farm will be operated in compliance with Government programs as follows:

(72) _____

3. **Debts and accidents.** Each party agrees that the other party shall in no way be responsible for the debts of, or liabilities for accidents or damages caused by, the other party.

4. **Willful neglect.** Willful neglect, failure, or refusal by either party to carry out any substantial provision of this lease shall give the other party the benefits of any proceedings provided by law.

5. **Arbitration of differences.** Any differences between the parties as to their several rights and obligations under this lease that are not settled by mutual agreement after thorough discussion, shall be submitted for arbitration to a committee of three disinterested persons, one selected by each party hereto and the third by the two thus selected; and the committee's decision shall be accepted by both parties.

6. **Landlord subordination.** In consideration of loan(s) to be made by the Farm Service Agency (FSA) the landlord hereby subordinates in favor of the FSA any lien the landlord now has or may acquire in or on: (a) the livestock and farm equipment purchased or refinanced by the tenant with FSA loan(s); (b) the crops, livestock increase and livestock products of the tenant (except a lien on such property produced in any year for that year's rent); (c) any other livestock and farm equipment owned by the tenant to the extent such lien is to secure advances to be made or supplies to be furnished by the landlord.

7. **Additional agreements:**

(73) _____

IN WITNESS WHEREOF, the parties have signed this lease on the date first above written.

Witness: (74) _____ (75) _____ [SEAL]

_____ [SEAL]

_____ (76) _____ [SEAL]

NOTE: The following statements are made in accordance with the Privacy Act of 1974 (5 USC 552a): the Farm Service Agency (FSA) is authorized by the Consolidated Farm and Rural Development Act, as amended (7 USC 1921 et seq., or other Acts, and the regulations promulgated thereunder, to solicit the information requested on its application forms. The information requested is necessary for FSA to determine eligibility for credit or other financial assistance, service your loan, and conduct statistical analyses. Supplied information may be furnished to other Department of Agriculture agencies, the Internal Revenue Service, the Department of Justice or other law enforcement agencies, the Department of Defense, the Department of Housing and Urban Development, the Department of Labor, the United States Postal Service, or other Federal, State, or local agencies as required or permitted by law. In addition, information may be referred to interested parties under the Freedom of Information Act (FOIA), to financial consultants, advisors, lending institutions, packagers, agents, and private or commercial credit sources, to collection or servicing contractors, to credit reporting agencies, to private attorneys under contract with FSA or the Department of Justice, to business firms in the trade area that buy chattel or crops or sell them for commission, to Members of Congress or Congressional staff members, or to courts or adjudicative bodies. Disclosure of the information requested is voluntary. However, failure to disclose certain items of information requested, including your Social Security Number or Federal Tax identification Number, may result in a delay in the processing of an application or its rejection.

According to the Paperwork Reduction Act of 1995, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0560-0162. The time required to complete this information collection is estimated to average 30 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. RETURN THIS COMPLETED FORM TO YOUR COUNTY FSA OFFICE.

(Acknowledgment in appropriate form to be attached).

FARM LEASE
Between

(Landlord)

(Tenant)

USE OF THE FARM LEASE FORM

This form contains suggested provisions for a livestock-share farm lease. Whether particular provisions should be included or modified in your lease depends on the agreements between the parties and whether the provisions are appropriate under the laws of your State. Spaces are provided for writing in particular details or special arrangements that a landlord or a tenant may want. By using the Annual Supplement to Farm Lease (Form FSA 1940-56). Details of the lease can be changed from year to year without preparing a new lease.

Prepared and issued by
U.S. DEPARTMENT OF AGRICULTURE



FSA-1940-51
(06-06-02)

U.S. DEPARTMENT OF AGRICULTURE
Farm Service Agency

CROP-SHARE-CASH FARM LEASE

(See Page 7 for Privacy Act and Public Burden Statements.)

THIS LEASE is entered into this (1) _____ day of (2) _____, (3) 20____
between (4) _____, landlord, of (5) _____
(Address of Landlord)
_____ and (6) _____,
tenant, of (7) _____
(Address of Tenant)

A. **PROPERTY RIGHTS.** The landlord hereby leases to the tenant, to occupy and use for agricultural and related purposes, the following described property, hereinafter referred to as the "farm," located in (8) _____ County, State of (9) _____, and commonly known as the (10) _____ farm.
Supplementary information: (11) _____

and consisting of (12) _____ acres, more or less, together with all buildings and improvements thereon, and all rights thereto except as specified below:

1. **Reservation of land and buildings.** The landlord reserves, the right to use the following land and buildings for the following purposes: (13) _____

2. **Right of entry.** The landlord reserves the right to enter the farm at any reasonable time for purposes (a) of consultation with the tenant; (b) of making repairs, improvements, and inspections; (c) of developing mineral resources; and (d) after notice of termination of the lease is given, of plowing, seeding, fertilizing and such customary seasonal work, none of which is to interfere with the tenant in carrying out regular farm operations. This right is also reserved to the landlord's agents, employees, and assigns.

3. **No right to sublease.** The landlord does not convey to the tenant the right to lease or sublet any part of the farm or to assign the lease to any person or persons whomsoever.

4. **Transfer of farm.** If the landlord should sell or otherwise transfer title to the farm, such sale or transfer will be subject to the provisions of this lease.

5. **Heirs and successors.** The terms of this lease shall be binding upon the heirs, executors, administrators, and successors of both landlord and tenant in like manner as upon the original parties. However, in event the lease is for more than one year, the heirs or successors of the tenant shall have the option to give written notice of termination effective at the end of the lease year in which death occurs.

6. **Right to lease.** The landlord has the right to lease the farm, and so warrants to the tenant. Further the landlord will defend the tenant's possession against any and all persons whomsoever.

7. **Rent additional land.** The tenant will not, unless written consent of the landlord is obtained first, farm more than (14) _____ acres of additional land and will not enter into any other business, occupation, or sideline.

8. **Additional agreements regarding property rights:**

(15) _____

B. LAND USE AND LIVESTOCK PRODUCTION

1. **Land use.** The agreed-upon use of the land is outlined in the following table:

(16) USE OF LAND	(17) ACRES	(18) FIELDS	(19) SEED VARIETY	(20) KIND OF SEED	(21) AMOUNT OF FERTILIZER PER ACRE
FOR FAMILY LIVING					
WOODLAND					
FARMSTEAD AND LOTS					
TOTALS (22)					

2. **Livestock production.** The tenant may engage in the following production of livestock:

(23) KIND OF LIVESTOCK	(24) MAXIMUM NUMBERS	(25) SPECIAL HEALTH, SANITATION, OR FEEDING PRACTICES

3. **Acres and numbers.** The acres of crops and the fields on which grown and numbers of livestock shown above are those planned for the first year of this lease. They may be adjusted within the year or from year to year by mutual agreement.

4. **Crop and livestock adjustments.** If it is impracticable in any year, from causes beyond the tenant's control, to grow the crops and to keep within the number of livestock according to the plan shown, appropriate adjustments will be made by mutual agreement between the parties.

5. **Restriction on livestock.** Neither the owner nor the tenant shall bring livestock that is not covered by this agreement on the farm during the period of the lease without express permission of the other party.

6. **Home use.** The tenant and landlord may take for home use the following kinds and quantities of jointly owned crops:

(26) _____

7. **Buying and selling.** The two parties will buy and sell jointly owned property according to the following agreement:

(27) _____

8. **Division of property.** At the termination of this lease, all jointly owned property will be divided or disposed of as follows:

(28) _____

C. IMPROVING, CONSERVING, AND MAINTAINING THE FARM. To improve the farm, conserve its resources, and maintain it in a high state of cultivation, the two parties agree as follows:

1. **General maintenance.** The tenant will maintain the farm during the tenancy in as good condition as at the beginning, normal wear and depreciation and damages from causes beyond the tenant's control excepted.

2. **Good husbandry.** The tenant will operate the farm in an efficient and husbandlike way, will do the plowing, seeding, cultivating, and harvesting in a manner that will conserve the landlord's property.

3. **Cropping practices.** The tenant will not, without oral consent of the landlord, (a) plow permanent pasture or meadowland, (b) cut live trees for sale or personal uses, but will take for fuel or use on the farm only dead or unmarketable timber designated by the landlord, (c) allow livestock other than the tenants own on stalkfields or stubblefields, (d) burn or remove cornstalks, corncobs, straw, or other crop residues grown on the farm, (e) pasture new seedings of legumes or grasses in the year they are seeded, and (f) plan legumes on land not known to be thoroughly inoculated without first inoculating the seed.

4. **Livestock practices.** In caring for livestock, the tenant will follow health and sanitation measures and guard against disease.

5. **Manure and crop residue.** The tenant will spread the manure, straw, or other crop residues on the farm as soon as practicable on fields agreed upon by the two parties, except as follows:

(29) _____

6. **Pasturing.** The tenant will prevent tramping of fields by stock and rooting by hogs when injury to the farm will be done.

7. **Waste.** The tenant will not commit waste on or damage to the farm and will use due care to prevent others from so doing.

8. **Fire protection.** The tenant will not, without written consent of the landlord, house automobiles, motortrucks, or tractors in barns, or otherwise violate restrictions in the landlord's insurance policy, which restrictions the landlord shall make known to the tenant.

9. **Replace losses.** The landlord will replace or repair as promptly as possible the dwelling or any other building that may be destroyed or damaged by fire, flood, or other cause beyond the control of the tenant or make rental adjustments in lieu of replacements.

10. **Noxious weeds.** The tenant will use diligence to prevent noxious weeds from going to seed on the farm and will destroy the same, and will keep the weeds and grass cut or destroyed on the fields, farmstead, roadside, and fence rows. Treatment of weed infestation and cost thereof, shall be handled as follows:

(30) _____

11. **Maintenance of improvements.** The tenant will keep the building, fences, and other improvements on the farm in as good repair and condition as they are when the tenant takes possession, and in as good repair and condition as they may be put during the term of the lease ordinary wear and tear, loss by fire, or unavoidable depreciation or destruction excepted.

12. **Materials and labor.** The landlord will furnish materials and the tenant will perform labor for normal maintenance and repairs, except that skilled labor which the tenant is unable to perform satisfactorily will be furnished by the landlord. Additional agreements regarding materials and labor:

(31) _____

13. **Purchase of materials.** The tenant may buy, without further authorization, materials for normal maintenance and repairs in a total amount not to exceed (32) \$ _____ within each year, and the landlord will credit or reimburse the tenant for such expenditures, as follows:
 (33) _____

14. **Add improvements.** The tenant will *not*, without written consent of the landlord, (a) erect or permit to be erected on the farm any nonremovable structure or building, or (b) incur any expense to the landlord for such purpose, or (c) add electrical wiring, plumbing or heating to any buildings, and, if consent is given, the tenant will make such additions meet standards and requirements of power and insurance companies.

15. **Conservation practices.** The tenant will control soil erosion as completely as practicable by stripcropping and contouring, and by filling in or otherwise controlling small washes or ditches that may form.

16. **Conservation structures.** The tenant will keep in good repair all terraces, open ditches, and inlets and outlets of tile drains, preserve all established watercourses or ditches including grass waterways when seed and fertilizer are furnished by the landlord, and refrain from any operation or practice that will injure them.

17. **Compensation for improvements.** The two parties will carry out new conservation practices and measures and make other improvements, and share contributions and costs necessary for completion of such practices and improvements as set forth below. The tenant will be reimbursed by the landlord when the practice, measure, or improvement is completed, or the tenant will be compensated for its unexhausted value when the tenant leaves the farm, according to the table below:

(34) CONSERVATION PRACTICE MEASURE, OR OTHER IMPROVEMENT	(35) DATE TO BE COMPLETED	(36) ESTIMATED COST \$	(37) PERCENT TO BE FURNISHED BY LANDLORD (L) AND BY TENANT (T)						(38) VALUE PLACED ON TENANT'S CONTRIBUTION \$	(39) RATE OF ANNUAL DEPRECIATION %
			MATERIALS %		LABOR %		MACHINERY %			
			L	T	L	T	L	T		

18. **Additional agreements relative to conservation and improvements:**

(40) _____

19. **Review of conservation program.** A new schedule covering conservation practices and improvements will be prepared each year on an appropriate form which will become a part of this lease when signed by the two parties.

20. **Preparing or seeding land.** When the tenant leaves the farm, if the total acreages of prepared or seeded land are greater than at the beginning of the tenancy, the tenant will be compensated by the landlord on the basis of the value of such excess acreages. If such total acreages are less than at the beginning of the tenancy, the tenant will compensate the landlord on the basis of the value of such deficiency, provided that the deficiency is not due to drought, flood, or other causes beyond the control of the tenant. The acreages at the beginning of this tenancy and the basis of payments are as shown in the table below:

(41) Prepared or Seeded	(42) Acres At Beginning	(43) Rate Per Acre

21. **Removable Improvements.** Minor improvements of a temporary or removable nature, not provided for in item 17 of this section, which do not mar the condition or appearance of the farm may be made by the tenant at the tenant's own expense. The tenant may at any time this lease is in effect, or within a reasonable time thereafter, remove such improvements, provided the tenant leaves in good condition that part of the farm from which they are removed.

22. **Compensation for damages.** When the tenant leaves the farm the tenant will pay the landlord reasonable compensation for any damage to the farm for which the tenant is responsible, except ordinary wear and depreciation and damages beyond the tenant's control.

D. SHARING COSTS AND RETURNS. All costs and returns shall be divided between landlord and tenant as provided below, unless otherwise specifically stated elsewhere in this lease.

1. **Rental rates.** The tenant agrees to pay as rent the shares or quantities of crops and cash as indicated below:

(44) CROPS OR IMPROVEMENTS	(45) ACRES	(46) SHARE RENT %	(47) CASH RENT \$	(48) PLACE OF SALE OR DELIVERY	(49) DATE OF SALE, DELIVERY, OR PAYMENT
FARM BUILDING					
DWELLING					

2. **Additional agreements in regard to rental rates:**

(50) _____

3. **Expenses.** Expenses, including investments in personal property, shall be supplied by the tenant, except as indicated in Paragraph C and except as follows:

(51) INVESTMENTS IN PERSONAL PROPERTY	(52) FURNISHED BY LANDLORD \$	(53) EXPENSES	(54) FURNISHED BY LANDLORD \$	(55) EXPENSES	(56) FURNISHED BY LANDLORD \$
TRACTOR		Labor		Liming Material	
MACHINERY & EQUIPMENT		Maintenance - Buildings		Fertilizer	
		Maintenance - Fences			
		Machine Repairs		Seed	
		Fuel - Tractor			
		Fuel - Truck			
		Fuel - Other		Electricity	
		Custom Work and Hauling		Telephone	
		Weed Control Material		Insurance-Buildings	
		Insecticides		Insurance-Crops	
		Feed Purchased or Supplied		Taxes-Real Estate	
LIVESTOCK		Livestock Expenses		Taxes-Personal	

4. Additional agreements relative to expenses:

(57) _____

E. TERM OF LEASE

1. **Term.** - The term of this lease shall be (58) _____ year(s) from (59) _____, (60) 20____ to (61) _____, (62) 20____ and this lease shall continue in effect from year to year thereafter until written notice of termination is given by either party to the other at least (63) _____ months before expiration of this lease or any renewal.

2. **Continuous occupancy.** - The farm will be possessed and occupied continuously during the term of the lease by the tenant of the tenant's agent.

3. **Surrender of possession.** - The tenant agrees to surrender possession and occupancy of the premises peaceably at the termination of the lease.

4. **Review of lease.** - A request for general review of the lease may be made at least (64) _____ days prior to the final date for giving notice to terminate this lease. Amendments and alterations to this lease shall be made in writing.

F. MISCELLANEOUS PROVISIONS

1. **No partnership created.** - This lease shall not be deemed to give rise to a partnership relation, and neither party shall have authority to obligate the other without written consent, except as specifically provided in this lease.

2. **Government programs.** - The farm will be operated in compliance with Government programs as follows:
(65) _____

3. **Debts and accidents.** - Each party agrees that the other party shall in no way be responsible for the debts of, or liabilities for accidents or damages caused by, the other party.

4. **Willful neglect.** - Willful neglect, failure, or refusal by either party to carry out any substantial provision of this lease shall give the other party the benefits of any proceedings provided by law.

5. **Farm records.** - The tenant shall keep a complete financial and production record of the entire farm business, which shall include a complete inventory of all property used in the farm business and a complete record of all purchases and sales related to the farm business. Such records are to be kept on mutually acceptable forms and shall be of such nature as to be usable by landlord and tenant in studying the farm business, in making financial and property settlements, and for purposes related to social security and income tax. Such records shall include appropriate sales statements, receipts, checks, and similar evidence and shall be accessible to the landlord at all times. Accounts between the two parties shall be settled on or about (66) _____.

6. **Arbitration of differences.** - Any differences between the parties as to their several rights and obligations under this lease that are not settled by mutual agreement after thorough discussion, shall be submitted for arbitration to a committee of three disinterested persons, one selected by each party hereto and the third by the two thus selected; and the committee's decision shall be accepted by both parties.

7. **Landlord subordination.** - In consideration of loan(s) to be made by the Farm Service Agency (FSA) the landlord hereby subordinates in favor of the FSA any lien the landlord now has or may acquire in or on: (a) the livestock and farm equipment purchased or refinanced by the tenant with FSA loan(s); (b) the crops, livestock increase and livestock products of the tenant (except a lien on such property produced in any year for that year's rent); (c) any other livestock and farm equipment owned by the tenant to the extent such lien is to secure advances to be made or supplies to be furnished by the landlord.

8. Additional agreements:

(67) _____

F. IN WITNESS WHEREOF, the parties have signed this lease on the date first above written.

Witness: _____ (69) _____ [SEAL]
(Landlord)

_____ (68) _____ [SEAL]

_____ (70) _____ [SEAL]
(Tenant)

(Acknowledgment in appropriate form to be attached).

NOTE: The following statements are made in accordance with Privacy Act of 1974 (5 USC 552a): the Farm Service Agency (FSA) is authorized by the Consolidation Farm and Rural Development Act, (7 U.S.C. 1921 et seq.), and the regulations promulgated thereunder, to solicit the information requested on this form. The information requested is necessary for FSA to determine eligibility for credit or other financial assistance, service your loan, and conduct statistical analyses. Supplied information may be furnished to other Department of Agriculture agencies, the Department of the Treasury, Department of Justice or other law enforcement agencies, the Department of Defense, the Department of Housing and Urban Development, the Department of Labor, the United States Postal Service, or other Federal, State, or local agencies as required or permitted by law. In addition, information may be referred to interested parties under the Freedom of Information Act (FOIA), to financial consultants, advisors, lending institutions, packagers, agents, and private or commercial credit sources, to collection or servicing contractors, to credit reporting agencies, to private attorneys under contract with FSA or the Department of Justice, to business firms in the trade area that buy chattel or crops or sell them for commission, to Members of Congress or Congressional staff members, or to courts or adjudicative bodies. Disclosure of the information requested is voluntary. However, failure to disclose information requested, including your Social Security Number or Federal Tax Identification Number, may result in a delay in the processing of an application or its rejection.

According to the Paperwork Reduction Act of 1995, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0560-0162. The time required to complete this information collection is estimated to average 30 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. **RETURN THIS COMPLETED FORM TO YOUR COUNTY FSA OFFICE.**

FARM LEASE
Between

(Landlord)

(Tenant)

USE OF THE FARM LEASE FORM

This form contains suggested provisions for a livestock-share farm lease. Whether particular provisions should be included or modified in your lease depends on the agreements between the parties and whether the provisions are appropriate under the laws of your State. Spaces are provided for writing in particular details or special arrangements that a landlord or a tenant may want. By using the Annual Supplement to Farm Lease (Form FSA 1940-56). Details of the lease can be changed from year to year without preparing a new lease.

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U.S. DEPARTMENT OF AGRICULTURE





AGRICULTURAL LAW AND TAXATION BRIEFS

DEPARTMENT OF AGRICULTURAL AND CONSUMER ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

IS YOUR LEASE COMPATIBLE WITH YOUR DIVISION OF USDA FARM PROGRAM PAYMENTS BETWEEN LANDLORD AND TENANT?

By Donald L. Uchtmann*

Synopsis: Whether a farm lease meets the technical definition of a "cash" lease or a "share" lease under federal regulations determines whether the farm operator, alone, or both the operator and the landlord is to receive certain USDA farm program payments. "Flexible" or "adjustable" cash rental arrangements, which technically may be "share" leases under the regulations, can be especially problematic. Improper division of farm program payments can result in ineligibility for farm program payments, and in some circumstances, a need to pay back previous payments. If a landlord and tenant have this problem, it may be wise for one to consult with legal counsel before taking further steps.

Whether a farm lease is technically a "cash lease" or a "share lease" under the Code of Federal Regulations (CFR) determines whether "Direct Payments" and "Counter-cyclical Payments" under USDA's Direct and Counter-cyclical Program must be distributed to (a) just the farm operator or (b) both the operator and landlord. Who can receive these payments is important for several reasons, including USDA farm program payment limitations.

For simplicity, this article will discuss only "Direct Payments" and "Counter-cyclical Payments" but the reader should realize that the technical classification of the lease may also affect how other program payments must be allocated, e.g., Loan Deficiency Payments and payments for *ad hoc* programs such as the Crop Disaster Program, the Livestock Feed Program, and the Livestock Indemnity Program.

Cash Lease vs. Share Lease: Technical Rules in the Code of Federal Regulations

Technically, for purposes of certain farm program payments, a lease is a "cash lease" if it "*provides for only a guaranteed sum certain cash payment, or a fixed quantity of the crop (for example, cash, pounds, or bushels per acre).*" 7 CFR 1412.504(a)(2). If the farm lease is technically a "cash lease" as just defined, the operator must receive 100% of the Direct and Counter-cyclical Program payments (the landlord is not eligible). 7 CFR 1412.504(a)(5).

For example, a farm lease calling for rent payments fixed at \$X per acre or Y bushels of corn per acre, and nothing more, would fall within the technical definition of a "cash lease." Thus, 100% of the farm program payments must be paid to the operator.

A "share lease" is also defined in the regulations. See 7 CFR 1412.504(a)(3) and 7 CFR 1412.504(a)(4). As

a practical matter, a "share lease" (for purposes of program payments) is probably any lease that is not a "cash lease" as previously defined. In a "share lease" situation certain program payments must be divided between the farm operator and the landlord (neither the landlord nor the tenant can receive 100% of the payment). See 7 CFR 1412.504(b).

Failure to pay 100% of the program payments to the operator in a "cash lease" situation, or to divide the payments between the operator and landlord in a "share lease" situation, can result in ineligibility for future farm program payments and trigger a need to pay back past payments. See 7 CFR 1412.604.

The Problem of "Flexible" Cash Rent, Hybrid Leases, and Combination Leases

"Flexible" or "adjustable" cash rent provisions are especially problematic. These provisions may change the character of the lease from "cash" to "share." This can happen even though the lease has some characteristics of a cash lease, is labeled a CASH LEASE on the lease form, and is viewed as a variant of a cash lease by farm managers. (Note: The terms "hybrid" or "combination" lease may also be used to describe leases incorporating various flexible cash rent arrangements.)

For example, a landlord and tenant honestly may believe they have a cash lease and agree that the operator-tenant should receive all the farm program payments. This "100% to tenant-operator" payment allocation would be required by the federal regulations if the lease in fact met the technical definition of a "cash lease." However, if the lease stated that the rent is the greater of a fixed sum (the pure cash rent component) or a certain share of the crop, it technically would be a "share lease" requiring a sharing of the program payments between landlord



AGRICULTURAL LAW AND TAXATION BRIEFS

DEPARTMENT OF AGRICULTURAL AND CONSUMER ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

and tenant, even if it were labeled a CASH LEASE. See 7 CFR 1412.504(a)(4).

Similarly, if the lease provided for "flexible" cash rent in the form of a fixed cash rent that would be adjusted upward or downward depending on actual crop yields or a combination of crop yields and crop prices, it might be viewed as a "share lease" under federal regulations. See 7 CFR 1412.504(a)(3).

Under federal regulations it is the technical substance of the lease that determines distribution of program payments, not the label on the lease.

Looking Ahead: Matching the Lease with the Desired Allocation of Farm Program Payments

Where existing farm leases are not compatible with the division of farm program payments desired by the landlord and tenant, there is a problem. It may be wise to discuss this problem with legal counsel before taking any other action. Such a discussion could address how much should be said to the Farm Service Agency and what might be left unsaid.

Looking to the future, the landlord and tenant may decide to revise the lease to avoid any future disputes about whether program payment allocations are proper, or they may decide to revise the allocation of farm program payments. The technical lease classification will need to match the division of program payments as prescribed in the Code of Federal Regulations, e.g., 7 CFR 1412.504. See the earlier discussion (Cash Lease vs. Share Lease: Technical Rules in the Code of Federal Regulations.)

Dealing with the Past: Program Payments Which May Have Been Allocated Incorrectly Because of Confusion about the Correct Lease Classification

The author understands that once the lease classification ("cash" vs. "share") and requested program payment allocation are made compatible for future program payments, it is unlikely that past problems will surface unless there is some event that brings the past history to the attention of the Farm Service Agency. Such events might include the

dissolution of a farm partnership, a change in the farm operator, or the current operator or landlord unwittingly pointing out the old problem to agency personnel. Once agency personnel are "given notice" of a past problem, even if it resulted from an innocent mistake, they may be required to take follow-up action that could include, for example, a demand that improperly allocated past payments be paid back.

Summary

The allocation of certain farm program payments between landlord and tenant must be compatible with the "category" of the farm lease ("cash lease" or "share lease") as determined by rules set forth in the Code of Federal Regulations. If the farm lease is technically a "cash lease" under federal regulations, the farm operator must receive 100% of the program payments. If the lease is technically a "share lease" under the regulations, payments must be shared between landlord and tenant. Failure to properly allocate payments between the operator and landowner, in light of the lease terms and federal regulations, can make a person ineligible for future farm program payments and trigger a demand that improperly allocated past payments be paid back.

Confusion exists about how "flexible" or "hybrid" or "combination" cash leases affect program payments. Especially problematic are leases that may be labeled a CASH LEASE but are technically "share leases" under federal regulations, or vice-versa.

If the lease and program payment allocations are not in harmony as required by federal regulations, it would be wise to consult with legal counsel as soon as possible. That discussion could address how much should be said to the Farm Service Agency and what might be left unsaid. Corrective action might include revising the lease to avoid future problems and simply providing a copy of the new lease to the FSA office without further comment. For the landlord and tenant, it may be best to focus on the future and not look back at previous program payments that may have been improperly allocated because of confusion regarding the proper technical classification ("cash" or "share") of the lease.

**Uchtmann is a Professor in the Agricultural Law Group of the Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign. He acknowledges the assistance of Mr. Stan Wilson, Farm Service Agency, in bringing these issues to his attention and providing technical expertise regarding the farm program payments affected, and the assistance of A. Bryan Endres, faculty member in the Agricultural Law Group. AGRICULTURAL LAW AND TAXATION BRIEFS are available at www.farmdoc.uiuc.edu/legal.*

Custom Farming: An Alternative to Leasing

Ag Decision Maker

File A3-15

Do you have the labor and machinery capacity to farm more acres, but do not want to lease more land? Would you like to reduce the financial risk exposure that you are carrying on leased crop land? Have you reached the payment limitation on one or more types of USDA commodity payments?

Are you a farm owner who does not want to invest in a full line of machinery? Are you fully employed away from the farm or retired?

An alternative to leasing farmland is custom farming. The custom operator agrees to perform all the machine operations on the owner's land in exchange for a set fee or rate. The landowner pays for all seed, chemicals, and other inputs, and keeps all of the crop and commodity payments.

One obvious advantage to the custom operator is that little or no additional operating capital is needed. Fuel, lubrication, and repairs are usually the only added costs. In addition, custom farming offers a fixed return. Although the possibility of higher repair bills poses some risk, this is minor compared with the price and yield risks faced by a tenant. In a good year, of course, profits from custom farming will be smaller than under a conventional lease, but this is a common trade-off for reducing risk.

Landowners find advantages to custom farming as well. Owners with small acreages can make most of the production and marketing decisions without investing in a full line of machinery. There are no lease payments to collect, since the owner receives all of the crop. The owner would usually be considered a material participant for tax purposes, and would be entitled to all government payments.

Responsibilities

Although the concept of a custom farming agreement is simple, close communication between operator and owner is essential. First, an accurate count of the number of acres to be farmed and their location should be agreed upon and recorded. Soil maps and field measurements available from the Farm Service Agency are helpful. A monitor on the planter can be used to estimate the number of tillable acres.

Second, the field operations to be performed need to be agreed upon. This will depend on the crop, field conditions, and conservation practices to be followed. The

number and timing of operations can be left somewhat flexible, in order to adjust for varying weather and pest conditions. The agreement can specify how much freedom the custom operator has to modify the original plan, but communication with the owner is important. The operator may have the added responsibility to monitor weeds and insects throughout the summer, and suggest actions to combat them.

The type and amount of pesticides to apply also will vary. The owner generally has the final word, although the responsibility can be delegated to the custom operator. If the custom operator is responsible for purchasing supplies and having them delivered, the owner and operator can agree on additional compensation, such as a percentage markup over the cost of these supplies or payment for time and mileage expended.

Time of harvesting should be a mutual decision between owner and operator. The moisture level of the crop must be checked closely. If the custom operator also has crops to harvest, varieties with different maturities should be used, to avoid harvesting bottlenecks. Some contracts call for the custom operator to take charge of drying and handling grain into storage, as well. Even if this is done with the owner's equipment, the operator can be paid a fixed rate per bushel for managing the drying and storage facilities.

Contracts

In all cases it is advisable to prepare a written contract. This doesn't need to be an elaborate legal document. Simply discuss and record the important points. This can avoid misunderstandings later, and provide evidence of the nature of the agreement for income and estate tax purposes. For further clarification the contract can specify that the operator is an independent contractor, not an employee, partner, or tenant of the owner. This limits the liability of the landowner.

Timing of payments is negotiable, but many custom operators prefer to get paid at least twice a year, following spring operations and fall harvest. Summer weed control and hay harvesting operations may make a third payment desirable. The operator should submit a written itemized statement of work completed, dates, acres, and payment rates to the owner. The agreement may require payment to be made within a specified period after the statement is

submitted. See Figure 1 for example.

Determining payments

Setting the payment rate may be the most difficult part of writing an agreement. *AgDM Information File, A3-10 Iowa Farm Custom Rate Survey* (FM 1698) reports average rates and ranges charged for custom farming and individual machine operations. Professional farm management firms also may be able to provide information about local custom rates.

Some contracts call for a single fixed rate per acre for all operations. However, many operators prefer to charge a separate rate for each operation performed. Many different combinations of tillage and weed control operations are possible. Conditions such as terraces, small and irregular fields, or special weed problems may justify a higher rate. Special factors such as timeliness, machine performance, and operator skill can command higher custom rates. Some operators prefer to charge by the hour for harvesting, mowing, and spraying weeds. Drying charges are usually based on the number of bushels handled, and hauling rates typically vary with distance, as well.

Incentive clauses, such as an extra 5 to 10 percent payment if crops are planted or harvested by a certain date, can be incorporated into an agreement. Bonuses based on actual yield also are used. However, the operator has no control over weather conditions that affect yields. Calculating the bonus by comparing actual yields to the county averages for the year would help compensate for some of the effects of the weather, although county average yield estimates are usually not available until several months after harvest. See Figure 2 for example.

Other considerations

Most custom operators inspect the land to be farmed before agreeing to a contract to check for field shape and

size, terraces, ditches and waterways, rocks, drainage problems, weed infestations, and access to storage facilities.

Custom operators should check with their insurance agents about obtaining insurance coverage or bonding against damage to machinery or property while doing custom work. Some agents offer special policies for custom operators.

Operators should be realistic about how many acres they agree to farm. *AgDM Information File, A3-25 Fieldwork Days in Iowa* (FM 1874) shows how many suitable fieldwork days can be expected at different times of the year. Leaving several extra days for emergencies reduces the risk of late planting or harvesting. Timeliness is important for customer satisfaction.

Most contacts for obtaining custom work come about informally. Simply let people know you are looking for work, or for a custom operator. Professional farm managers can help match up owners and operators. Placing classified ads in newspapers and farm publications is useful. Some operators print up cards or flyers describing their services and post them in places frequented by farm owners, or incorporate them into a professional web site.

Custom operators need to know their own machinery and labor costs. However, the operator may not always be able to charge enough to cover all costs if others are willing and able to do the job for less. Over time, making the extra effort to do high quality work and to communicate regularly with the landowner will probably have more influence than price on the demand for the services of a custom operator.

... and justice for all

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Figure 1. Contract for custom farming for the year _____.

PARTIES

This contract is entered into by (name) _____
of (address) _____
contractor, and (name) _____
of (address) _____
owner, on (date) _____

DESCRIPTION OF FARM

The contractor agrees to perform custom farming operations for the owner on the following land or parcels of land:
(include county, township, and section number) _____

METHOD OF PAYMENT

The contractor agrees to submit to the owner an itemized written statement of work completed after (date, or last operation to be completed) _____ and _____
The owner agrees to make payment to the contractor within _____ days after receiving the statement.

PROCUREMENT OF SUPPLIES

(describe who is responsible for the purchase and delivery of seed, fertilizer, chemicals and other supplies, and procedure for reimbursement, if any) _____

OTHER PROVISIONS

(parties may wish to include language regarding bonus or incentive payments, contractor's right to subcontract, or owner's right to hire a different contractor) _____

Figure 2. Acres, field operations and rates^{1/}.

	Unit (acre, hr., bu.)	Rate per unit	Field 1 _____ ac.	Field 2 _____ ac.	Field 3 _____ ac.	Field 4 _____ ac.
Crop			_____	_____	_____	_____
Operation						
chop stalks	_____	_____	_____	_____	_____	_____
chisel plow	_____	_____	_____	_____	_____	_____
tandem disk	_____	_____	_____	_____	_____	_____
spray	_____	_____	_____	_____	_____	_____
field cultivate	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
plant	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
spray	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
combine corn	_____	_____	_____	_____	_____	_____
combine soybeans	_____	_____	_____	_____	_____	_____
dry grain	_____	_____	_____	_____	_____	_____
haul grain	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____

^{1/} Fields may be described on page one of the contract, or on an attached map or description. Indicate with an X which operations are to be performed on each field. Several fields may be combined into the same column if the same operations will be performed on each of them.

Farm Leases

Christine E. Nicholas
presented to ISB Real Property Section
November 4, 2015

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FARM LEASES

- Idaho farm lease statistics:

Farmland	2007	2012
tenants/acres	1,553 on 834,383 acres	1,698 on 931,420 acres
part owners/acres	5,472 on 5,388,009 acres*	5,843 on 5,500,719 acres*
full owners/acres	18,324 on 5,274,991 acres	17,275 on 5,327,970 acres

*some of this acreage is rented land in farms

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FARM LEASES

- if lease term > 1 year, must be in writing to be enforced
 - part performance may satisfy statute of frauds
- principal types of farm leases:
 - *Fixed Cash*
 - *Flexible Cash*
 - *Share-crop*
 - *Custom Farming Contract*

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FARM LEASES

- *Fixed Cash*
 - Advantages:
 - simple with few chances for misunderstanding
 - owner relieved of day-to-day operating decisions
 - owner has very little financial risk
 - tenant has maximum freedom in planning and developing the cropping and livestock programs
 - tenant has fewer records to keep when multiple landlords are involved

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FARM LEASES

- *Fixed Cash*
 - Disadvantages:
 - fair cash rental rate may have to be renegotiated each year
 - cash rents likely to be too low in times of rising prices and increasing yields, and too high in times of low prices or low yields
 - selling prices and production costs may be higher or lower than anticipated when the rental rate is set
 - tenants are required to supply more operating capital
 - tenants bear all risk of production shortfalls

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FARM LEASES

- *Flexible Cash*
 - Advantages:
 - amount of rent increases or decreases automatically from year-to-year as prices and yields change
 - reduced need for owner and tenant to renegotiate rental rate each year

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FARM LEASES

- *Flexible Cash*
 - Disadvantages:
 - both parties must agree on a formula for setting the cash rent each year
 - both parties must agree on how to determine the prices and yields to include in the formula
 - uncertainty about how much the tenant will pay and owner will receive each year

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FARM LEASES

- *Share-crop*
 - Advantages:
 - risks associated with price and yield variations are shared
 - owner is more involved in making decisions and marketing crop during the year
 - both parties share benefits from adoption of yield-increasing technology or unexpected high yields or prices
 - owner receives more information about yields and inputs used each year
 - a second USDA payment limit is created

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FARM LEASES

- *Share-crop*
 - Disadvantages:
 - landlord and tenant must agree on how production expenses will be shared
 - may need to make adjustments for sharing costs for storage and drying facilities, herbicides that reduce field work, or fertilizer and pesticide application
 - parties must agree on cropping plan to be followed and whether or not the farm participates in government programs
 - may have to negotiate added cash rent for the use of buildings and storage facilities
 - if the owner's and tenant's harvested crop is co-mingled, marketing decisions have to be made jointly
 - landowner may be considered a material participant, and farm income may be subject to self-employment taxation

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FARM LEASES

- *Custom Farming Contract*
 - Advantages:
 - very little financial risk for the operator
 - owner benefits from any unexpected high prices, yields or government program payments
 - only one party is responsible for marketing crop and making production decisions
 - agreements are usually fairly simple to negotiate

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FARM LEASES

- *Custom Farming Contract*
 - Disadvantages:
 - owner bears all the risk of low yields or prices, or high input costs
 - number and timing of field operations to be done each year may have to be modified, depending on weather conditions
 - operator has to set priorities among the custom farmed land and other rented or owned land
 - owner must communicate to the custom operator the cropping system, fertility program and type of pest control to be used
 - crop inputs such as seed, fertilizer and pesticides must be purchased and delivered in a timely manner
 - landowner may be considered a material participant, and farm income could be subject to self-employment taxation

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FARM LEASES

- *lease tips*
 - have a clear understanding of the business terms of the lease
 - put the lease in writing
 - make sure the lease clearly states any restrictions or limitations on the use of the land or water
 - if you want an alternative dispute mechanism (mediation or arbitration), make sure the lease contains clear provisions/direction on how disputes will be resolved

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FARM LEASES – representative Idaho cases

- *Steel Farms v. Croft & Reed, 154 Idaho 259, 297 P.3d 222 (2012)*
 - general contract interpretation principals apply to farm leases:
 - court must look to the contract as a whole and give effect to every part of it
 - court will enforce the language of a contract where the language is plain and unambiguous
 - if an ambiguity exists, parol evidence may be considered to determine intent
 - merger clause does not require amendment be in a separate writing
 - amendment can be done by interlineation to original lease

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FARM LEASES – representative Idaho cases

- *Steel Farms v. Croft & Reed, 154 Idaho 259, 297 P.3d 222 (2012)*
 - whether irrigation system is a fixture is a mixed question of fact and law
 - trier of fact must analyze 3 tests:
 - is the property annexed to the realty
 - is the property adapted or applied to the use or purposes of that part of the realty to which it is connected
 - did the parties intend to make the attached property a permanent accession to the realty

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FARM LEASES – representative Idaho cases

- *Corder v. Idaho Farmway*, 133 Idaho 353, 986 P.2d 1019 (App. 1999)
 - part performance of an oral farm lease will satisfy statute of frauds
 - part performance may be shown by:
 - tenant taking possession of the farm ground
 - tenant farming the ground for one season and preparing farm ground for following year's crop
 - tenant making payment to landowner and landowner accepting payment

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GRAZING LEASES

- in Idaho, private rangeland grazing leases are generally informal, year-to-year arrangements
 - terms negotiated on an annual basis
- season-long or require a rotational grazing program
- 2011 average rate \$16.04/AUM
 - landowner daily livestock care added \$2.20/AUM
 - leases with yearling cattle or irrigation increased rate

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GRAZING LEASES

- 3 types of payment to consider:
 - flat fee per acre or as whole unit
 - monthly payments or after grazing season
 - fee per head per month
 - monthly payments or after grazing season
 - other
 - may charge more for heavier grazers
 - may charge more for landowner-provided services
 - may charge more for irrigation

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GRAZING LEASES

- good drafting principles are common to both private grazing leases and farm leases:
 - lease should be in writing
 - clearly set forth the economic terms
 - clearly state any restrictions on use
 - limitation on the number of head or other ways to prevent over-grazing
 - clearly state the parties' rights and remedies

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