

MU Guide

Farm Lease Agreement

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The purpose of this guide is to provide tenants and landowners basic information needed to write rental agreements. Changes in the structure of production agriculture have increased the need for persons entering a contractual rental arrangement to have a written agreement. Additionally, rental agreements should be updated regularly to incorporate changes in government programs, environmental regulations, costs of production and revenue received. Refer questions pertaining to the law of lease contracts to your attorney.

Value of a written lease

The value of a written contract is in helping the prospective landowner and tenant think about and agree upon the essential considerations of leasing and operating the farm.

To arrive at an equitable lease, the interested parties should talk over the basic considerations involved in the leasing arrangement and in managing the farm. They should then make a contract, preferably written, based on these considerations.

Provisions of farm lease agreement

A written lease should include at least the elements described in sections 1, 2, 3, 9 and 12 of this publication. Oral agreements usually are not discussed as thoroughly as the written lease. Misunderstandings occur when terms of an oral agreement deviate from established customs of the community. Therefore, the following discussion will provide guidance in developing a written contract.

1 – Names of parties and description of property

Every lease should identify the parties entering into the lease contract and give the legal description of the property or properties involved. In addition to the legal description, information such as the distance and direction from town, road name, mailing address and popular name of the farm might be given.

2 – Term of lease

The term, or length of time the lease is to be in effect,

should always be agreed on and should be stated in the contract.

The term of the lease is important. A long-term lease is often necessary to develop a profitable business over time because of the need for permanent capital investments. The tenant will not want to share investment in permanent facilities on a short-term lease. Usually, landowners favor a short-term lease on the basis that a longer-term lease lowers the market value of the farm because it cannot readily be sold. This problem can be solved by including a termination clause that would apply in case the farm was sold.

The lease agreement can be for either a one-year lease or a longer lease, as desired. Most agreements include an automatic renewal clause and allow some flexibility in the terms of the lease if the parties under contract give adequate notice. Unless specified otherwise in writing, notice must be given to the tenant two months before the lease agreement. For the written agreement, the expiration date is 10 months from the date of the beginning of the agreement as stated in the written contract. For the oral agreement, this date is more difficult to determine.

In some communities, it is customary to give notice that the lease is to be terminated before wheat sowing time in the fall or by March 1 in the spring. But failure of either party to give this notice does not necessarily indicate a desire that the lease be continued. Consequently, it is desirable to state in the contract the procedures to be followed for terminating or continuing the lease contract.

3 – Rental rates and arrangements

Rental rates and arrangements for payment or disposition of the rent are a significant part of any lease, whether written or oral.

Basically, there are five methods of paying rent: crop-share rent; livestock-share rent; cash rent; flexible cash rent; and farm machinery, equipment and buildings rent.

The cash lease is the most common. The second most often used is the crop-share lease. Flexible cash

rental agreements are increasing in use as tenants seek to share downside revenue risk with landowners and landowners seek to capture upside revenue potential. The rental arrangement for each specific farm should be developed to fit the farm and the planned operating procedures. These conditions are known best by the landowner and prospective tenant, so they should work out the most satisfactory arrangement between them. No standard lease form can be used to develop an equitable rental agreement. The function of the form is to record operating procedures agreed upon by the parties entering the contract.

Crop-share rent – Characteristics of a crop-share lease are that each party receives a share of the crop as earnings for their contribution in land, labor and capital. Normally, crop-sharing involves grain crops such as small grains, corn, milo and soybeans and land used to participate in government programs. Remaining areas used in producing forages (hay and pasture) are normally cash rented.

The landowner's share of the crop depends on the contribution made toward production of the crop. When crops are divided 50-50, the landowner normally pays 50 percent of the cost of fertilizer, seed and chemicals in addition to providing the land. In other instances, the landowner may or may not share in cash production costs and receives a $\frac{1}{4}$ to $\frac{1}{2}$ share of the crop as a return to land.

Livestock-share lease – Livestock-share leases vary considerably because of differences in contributions made to the business by each party. The owner normally furnishes land and buildings, while the tenant furnishes major portions of the crop machinery. Livestock is owned jointly. Production costs such as feed, veterinary and medicine, other livestock expenses, fertilizer, seed and chemicals are shared equally.

Livestock machinery and equipment may be jointly owned. Labor costs are shared according to the agreement, as are repairs and upkeep on permanent buildings. The landowner usually pays for construction of permanent buildings, or arrangements are made to reimburse the tenant in case the lease is terminated. Livestock and crop sales are divided according to the terms of the agreement.

Cash lease – The cash lease is normally uniform and relatively simple. The tenant pays the landowner a cash sum per acre or a lump sum for his or her investment in farm resources. Provisions in the lease generally state the terms of agreement. For example, the landowner may place restrictions on the use of land or fields for certain crops. Also, the agreement might state the degree of productivity to be maintained. Provisions should also state the amount and method of paying rent.

Flexible cash lease – The flexible cash lease is a hybrid of the cash lease. The flexible cash lease agreement states that the tenant will pay in proportion to either or both the price and the yield level. There are

many methods for flexing the rental agreement. The most common method is flexing gross (or net) revenue so that the tenant and landowner share the risks associated with cash renting. If revenue is greater than the established base level, the tenant and landowner share the excess revenue. If revenue is less than the established level, the tenant and landowner share the lost revenue. However, often there is a cash lease price floor that the landowner is guaranteed. Other types of flexible cash rental arrangements include flexing only price or yield or flexing both.

Farm machinery, equipment and buildings leases – Renters have found that leasing unused resources can be cheaper than making new capital investments. Also, producers have found in certain situations leasing machinery and equipment from dealers can be cheaper than purchasing. Additionally, machinery and equipment leasing arrangements can be between renters and owners to allow the renter to avoid paying full value and the owner to generate revenue to cover the ownership costs. Renters need to compare the size, condition, obsolescence, use, location and lease cost of the capital good versus the cost of purchasing the capital good outright. Owners are primarily interested in recovering ownership costs. The lease price should equal the amount needed to cover ownership costs and variable costs, such as upkeep costs incurred from renting the capital good. Both renters and owners should consider current value, depreciation, interest, insurance and taxes, inflation, repairs and maintenance when agreeing on a lease value.

4 – Farm operating expenses

Reaching agreement on farm operating expenses provides an opportunity for the tenant and landowner to discuss and designate the share of cash production costs that are to be paid by each party.

5 – Conservation and improved practices

To improve or maintain the productivity of the farm, conservation and improved production practices are usually warranted. Normally, conservation and other improved farming practices require additional labor and expenditures. Give important consideration to questions such as who contributes the labor and cost of implementing the practice and how these contributions affect income for both tenant and landowner.

6 – Improvements and repairs

Misunderstanding is prevented by agreeing ahead of time what repairs will be done, how much will be done and what each party will furnish toward them.

In many instances, tenants provide equipment that legally becomes permanent fixtures on the farm. Disagreements can be avoided and the farm's resources more fully used if both landowner and tenant agree on needed improvements and further agree on an amorti-

zation schedule. The compensation schedule should be based on local conditions and the individual farm.

7 – Records

Farm records are a necessary part of farming. The records need not be elaborate or formal accounts but at least should cover all the expenses affecting both parties. The tenant is the logical person to keep the records because he or she is usually in closer touch with the day-to-day operations. If the records are kept as part of a complete farm account record, they will have greater value to the total business.

Farm account record systems are available at your local University Outreach and Extension center.

8 – No partnership

A lease does not create a partnership. A statement of this nature is advisable in any lease form.

Rental arrangements involving livestock-share leases are more apt to be considered partnerships than the crop-share arrangements, but such arrangements are more likely to be considered modifications of the landowner-tenant relationship as traditionally established under the crop-share lease.

9 – Right of entry

Every farm lease agreement should include a statement giving the landowner the legal right to enter the property. Without such a statement, a tenant has the

right to treat any entrant on the property as a trespasser, including the landowner.

10 – Arbitration (settlement)

Differences of opinion can arise rather unexpectedly. For this reason, leases should be in writing. Time tends to make oral agreements hazy while a written agreement is always available for reference and recall. Also, a written lease forces both parties to “argue out” their differences in most areas where differences of opinion may occur. This section is included to encourage the use of disinterested persons for settling differences promptly and in a friendly manner rather than by litigation.

11 – Additional agreements and modifications

It is often necessary to change or add to contractual arrangements, and one of the tests of a good lease is its flexibility for changing the operating plan. Any changes made after the initiation of the original contract should be made a part of the written contract.

12 – Signatures

Signatures by each party are one of the five essential parts of the lease contract. The agreement becomes a contract when it is signed. All co-owners of the property, including husband and wife, should sign the lease agreement when property is held in joint tenancy or tenancy by entireties.

For further information

- G 427 *2006 Cash Rental Rates in Missouri*
- G 428 *Customary Farm Rental Arrangements*
- G 429 *Leasing Farm Equipment*
- G 520 *Verbal Farm Rental Agreements Under Missouri Law*
- G 530 *Rental Agreements for Irrigated Land*
- NCR 75 *Fixed and Flexible Cash Rental Arrangements for Your Farm*
- NCR 105 *Crop-share or Crop-share/Cash Rental Arrangements for Your Farm*
- NCR 107 *Livestock Share Rental Arrangements for Your Farm*
- NCR 148 *Irrigation Crop-share and Cash Rental Arrangement for Your Farm*
- NCR 149 *Pasture Rental Arrangements for Your Farm*
- NCR 214 *Rental Agreements for Farm Machinery, Equipment and Buildings*

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