Using Leases to Meet Financial and Stewardship Goals

Prepared for
Land Stewardship Project

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Landowner Benefits of Leasing

- Reliable revenue stream
- Property tax advantages
- Burden of property maintenance can be shared
- Land management that meets landowner’s stewardship goals
Landowner Benefits of Leasing

- Keeping land in production
- Offering opportunity to new farmer or farm family
- Flexibility: can be a “trial period” if considering transitioning land

Key Points to Remember

- There are many non-legal considerations not covered by this presentation, including:
  - Financial and stewardship goals assessment, assessment of land, suitable operations for the land, how to find the right tenant, and more.
- Successful relationships are built on shared values and good communication.
- Communication is critical at every stage of the relationship.
Basic Lease Requirements

- Leases are governed by state law.
- Land leases for more than one year MUST be in writing.
- Land leases for one year or less (12 months, not a crop year) can be valid even if not in writing...
  ...as long as agreement on basic terms.

Basic Lease Terms

- Names of landlord and tenant
- Description of the property to be rented
- Rent amount ($)
- Lease term, with start and end dates
- Usually, signatures of both landlord and tenant
Lease Length

- Short-term leases (1-3 years) offer flexibility; can be a trial period.
- Long-term leases are more secure and allow tenant to invest in the operation and the soil. State law may limit ag lease length
  - Ex. MN 21 years, WI 15 years
- Depends on parties’ goals and needs

Lease Length

- Rolling leases have the term “rolled over” each year.
- 3+ years generally best for sustainable practices, as longer lease = greater stake for tenant
- Takes time for financial benefit, soil health
  - Sustainable farm tenants add value
Payment Options

- **Cash Lease**
  - Agreed amount paid regardless of the success of the operation.
  - Often split; some paid at beginning of lease, remainder at end of season.

Determining Cash Rent Amount

- Amount of cash rent is based on many factors, including:
  - Market rental rates
  - USDA county average rental rate
  - Location
  - Soil quality
  - What else comes with the land – e.g., irrigation, equipment, tilling, etc.
  - Personal needs
Cash Payment Options To Encourage Sustainable Practices

- Graduated Rent – Lower initial rent
- Accounts for extra cost of sustainable practices, accounts for possible reductions in yield (especially in first years)
- Rises as new farmer learns and yields improve

Sample Provision

The total rental amount for the 1st year shall be reduced by 20%, for the 2nd year by 15%, for the 3rd year by 10%, and for the 4th year by 5%. Tenant shall pay the total rental amount in the 5th year and beyond.

Crop-Share Lease

- Rent is a specified share of crop
- Takes farm yield & market price into account. Shares risk.
- LL or tenant sells product
- Sometimes the landowner and tenant split both costs and profits.
Crop-Share Lease

- **NOTE**: Impact on USDA farm program payments, taxes, social security payments
  - Because LL viewed as self-employed as part owner of farm operation

Flexible Cash/Crop-Share Lease

- Hybrid of cash and share models.
- Parties agree on a base rent price that is less than straight cash lease.
- Landowner receives portion of proceeds from sales.
- In good years, both parties benefit; in bad years, landowner still receives base rent.
Flexible Cash/Crop-Share Lease

- The additional rent can be based on farm yields, crop prices, revenues
- High yield = higher rent, Low yield = lower rent, etc. (actual yield or county yield average)
  - NOTE: Impact on USDA farm program payments (if based on actual yield).
- Price (market & date) vs. revenue (safer)
- Put it in Writing! (Pick calculation, percentage, etc.)

Managing Risk: Insurance

- **Standard homeowner’s insurance policy usually does not include activities relating to commercial farming.**
  - Can ask tenant to show a certificate of insurance from agent, naming landowner as “additional insured.” **OR**
  - Landowner adds “incidental farm and animal liability endorsement.” May not be available from insurer. **OR**
  - Landowner replaces her homeowner’s insurance policy with their own farm liability policy. Makes most sense if landowner is partnering with tenant in farm operations. **OR**
  - Landowner keeps her homeowner’s policy and adds commercial liability policy that covers “lessor’s risk,” also known as landlord liability insurance.
Environmental Laws

- Compliance with federal, state, and local environmental regulations.
  - Ultimate responsibility is with landowner.
  - Important to make sure tenant is complying with those laws.
  - Lease agreement can specify that tenants are responsible for following all federal, state, and local environmental regulations
- Pesticide application. Discuss expectations up front and include in lease.

Zoning

- Zoning is governed by local ordinances.
- May need permit for certain things, such as new structures, greenhouses, housing, farm stands.
- Specify who is responsible.
Using Rent to Encourage Sustainable Practices

- **One-time Rent Reduction**

  Sample Provision
  
  The first annual rent amount shall be reduced by $___.

- **Reduction to Reward Specific Practices**

  Sample Provision
  
  The agreed rental amount shall be reduced by 20% for cropland acres in transition to certified organic status, and the agreed rental amount shall be reduced by 25% for certified organic cropland acres.

Encouraging Sustainability

- **Reimbursements or cost-sharing for improvements**
  
  - Normally become LL property (unless agreed otherwise)
  - Protects against tenant capital or effort loss
  - LL approval prior to construction
Encouraging Sustainability, cont’d

- Sharing costs of sustainability practices
- Requires ongoing communication
  - Reports on farm operation (OSP, FSA reports)
  - Calls, emails, letters

Requiring Sustainability

- NRCS plan can be incorporated into lease
- Threshold and monitoring provisions can be included in lease (e.g., acceptable levels of soil erosion). Be sure to spell out who pays. If tenant, should be factored into rent calculation.
- If land is already enrolled in a conservation or preservation program, be sure to include in the lease the requirement that tenant must comply with all requirements of the program.
Other Lease Options

- **Ground Lease**
  - Own house, barn, fencing, etc. (non-removable improvements), but rent land (or most land).
  - At end, improvements sold (next tenant, LL).
  - Allows tenant to build equity over time.

- **Contract for deed**
- Option to buy, right of first refusal

Contracts for Deed

- Seller keeps legal title until contract paid in full
- Advantages:
  - Quicker and simpler than a mortgage
  - Can provide financing option for those who don’t qualify for a mortgage
  - Lower down payments and interest rates and no mortgage origination fees
  - Tax advantage for sellers
Contracts for Deed

- **Disadvantages:**
  - Buyers risk losing all money paid (equity) if contract for deed is canceled
  - For buyers, can be canceled more quickly than a mortgage can be foreclosed—same protections not available
  - Requires ongoing responsibilities from seller

Other Lease Issues

- **How to get out!**
- **Consequences of landowner bankruptcy**
  - Generally, tenant can stay until end of lease term, but may have to assert rights, pay rent to new owner. Best case – put in lease.
- **Consequences of tenant bankruptcy**
  - LL can get priority lien but have to perfect
- **Subletting**
- **Default**
Review: Analyze & Negotiate

- Read the entire lease.
- Using a checklist, check for “danger zones.”
- Decide what you need to change; cross out or write in terms and negotiate.
- Everything is theoretically negotiable; need not accept all “boilerplate.”
- Get everything in writing.

Review: Analyze & Negotiate

- Legal counsel worthwhile.
- Sample or template leases are a good place to start. Getting that start can save you time and money when you bring it to an attorney.
Farm Lease Resources

- Sustainable Ag Land Tenure (SALT) Initiative
  - sustainablefarmlease.org, Sustainable Farm Lease Guide
- Iowa State Extension Ag Decision Maker
  - Sample leases, extension.iastate.edu/agdm
- The Land Connection, thelandconnection.org
  - Guide for Land Seekers (resource list)
- California Farm Link, californiafarmlink.org
  - A Farmers’ Guide to Securing Land
- Land For Good, landforgood.org
  - Sample leases
  - A Landowner’s Guide to Leasing Land for Farming
- Farm Transitions Toolkit, LSP
  - landstewardshipproject.org, FLAG

THANK YOU!

Questions?

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