

Agricultural and Farm Leases:

Economic and Legal Aspects

for

Virginia Farm Owners and Tenant Farmer

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TABLE OF CONTENTS

- I. Leases - The Facts - Why Lease

- II. Risk
 - A. Economic and Financial

 - B. Physical and Legal

- III. Getting Started
 - A. Selecting a Tenant

 - B. Selecting a Landlord

 - C. Written vs. Oral Learning

- IV. Legal Aspects of a Lease Agreement
 - A. Law of Leases

 - B. Notice Requirements

 - C. Rent and Landlord's Lien

 - D. The Landlord's Lien and Article 9

- E. Rights and Duties of Tenant
- F. Liability for Tenant in Case of Fire or Other Disaster
- G. The Right of Tenant in Case of Sale
- H. Lease Covenants
- I. Environmental Concerns
- J. Tax Considerations
 - 1. Income
 - 2. Estate Tax and Special Use

V. Economics of a Lease

- A. How much rent to pay or change
- B. Rent or Buy
- C. Rent and Buy
- D. Major Objectives of a Lease

VI. Major Types of Leases

A. Crop Leasing

B. Animal Leasing

C. Building Rent

VII. Drafting the Lease

A. Five Basic Requirements

B. Partial Checklist of Additional Items to include in a Lease

VIII. Sample Farm Lease Agreement (Multiple Provisions)

Agricultural and Farm Leases:

Economic and Legal Aspects for Virginia Farm Owners and Tenants

I. Leases - The Facts - Why Lease

Nationwide, 45 percent of all agricultural land is leased and 41 percent of all farmers operated at least some leased land. [Denise M. Rogers, “Leasing Farmland in the United States”, RTD, ERS, USDA AGES - 9159, 1992 p.2] percent of Virginia land was leased. Three hundred thirty-two million acres of farmland is leased to others by 1.5 million owners, under 1.9 million leases. [Rogers, p. 4]. Eighty-four (84) percent who lease land are individuals or families (68 percent of acres), 9 percent partnership; (10 percent of acres) 4 percent corporation (17 percent of acres) and trust, estates, foreclosure and other private group are 3 percent of land owners. (5 percent of acres) [Id.]

Access to Land: The Leasing Option

Rented farmland is essential to virtually every full-time farming operation and many part-time Virginia farmers. Leasing farmland is particularly important for new and beginning farmers. According to the 2007 Census of Agriculture, over 15,000 farms in Virginia lease a total of nearly 3,000,000 acres of farmland in the state.

Eighty-eight (88) percent of landlords lease only to one tenant and 70% of the owners of land who lease own less than 180 acres of land - (Id) The largest group of agricultural land lords are women (40%) followed by men (31%) and jointly held property, men and women (29%) [Id. P. 7]. Sixty-five (65) percent of owners who lease out land are 60 years of age or more and 39% are 70 or older. [Id. p. 6] Thirty-seven percent of landlords live on the rented land and over 50 percent within five miles [Id. p. 6] Historically, most agricultural landlords were closely associated with farming as retired members of farm families. USDA now reports that 62 percent of landlords are neither engaged in farming nor retired from an agricultural activity. [Id p. 11]]

Leases or renting play an important role in farming. Many farmers could not stay in business without operating through lease arrangements.

Future business and estate planning needs are likely to continue the trend of intra-family leasing of agricultural land, buildings, and equipment and agricultural program allotment. With the high cost of farm machinery, the economic concept of the long run average cost curve comes into play. Driving the same combine over more acres reduces the per acre cost harvesting a crop. The same is true for most other equipment uses.

Different types of leases have been developed to meet the needs of various types of farming operations. For many farmers, a lease or rental agreement may be the best method of controlling more land resources, reducing per unit equipment cost resulting in a more efficient and profitable operation. Leases may also be the only way that new farmers can enter into agriculture as they do not have access to capital to purchase land on buildings. Leasing allows landlords a source of income. In many cases, leasing allows the farmer and spouse to reap an extra retirement

income from inherited property or investment property while the property provides a hedge against inflation or represents a secure investment.

The terms leasing and renting are used interchangeably in this publication. Although land, the major item leased in the agricultural field, leasing of buildings, animals and equipment are sources of income as well. Although this publication will deal primarily with land leases, many of the economic and legal issues are the same and should be approached with the same concerns.

II. Risk

Leases involve the sharing of risk between the landlord and tenant. There are two major types of risk involved—economic and physical risk. The lease should spell out how these risks will be divided. In absent of an agreement, the law may decide these issue for the lessor (landlord) and lessee (tenant). Both these types of risk will be explored in this publication.

However, it would be wise to outline the two major risks that land lord and tenants face. (should we use landlord tenant or lessor and lessee?)

A. Economic and Financial

Several types of leases—cash rent, crop share, pasture rental, livestock share, labor share, equipment rental and flexible - rent leases—have developed overtime to accommodate the needs of landlords and tenants. The two major types of lease are cash rent or crop or animal share leases. Flexible rent leases are a complex combination of cash rent and crop share. The major differences between cash-rent and crop share is how production (quantity of out put) and price (prices per input units of production) risk are shared between the land owner and the lease holder.

Cash rent (\$ per acre, \$ per cow) transfer yield (draughts, late

planting and harvesting) and prices variability risk to the lessee or renter. Likewise the ability to profit from high yield and better marketing decisions are transfers as well. The land lords major risk are non-payment of rent and physical damage or abuse to the land or other asset. Crop-share leases allow both the landlord and tenant to share in physical loss with each making their own marketing decision and both share in the physical gain/loss.

B. Physical and Legal Risk

Physical risk associated with yield is a part of economic risk and discussed above. Other physical risk are legal in nature and discussed below. Physical loss include loss of soil fertility, pollution of soil, non-payment of rent, the theft of property, ejectment from the land, physical deterioration of property, loss

by fire, liability to invitees and licensees who enter upon the property.

The goal of a well drafted lease is to spell out how the risk is to be born or shared and to provide for redress to the aggrieved party when there is a conflict from failure of either party to live up to the terms of the physical and economic sharing of risk.

The lease agreement determines what level of risk and returns will be undertaken and received by each party. Based on expected long term averages, the lease also will determine who bears the loss of unexpected unfavorable events and receives the gain from unexpected favorable events. Not all tenants can bear the risk of a cash rent. Tenants are more likely to prefer share agreements. More seasoned or financially sound tenants

may to prefer cash rent to reduce recordkeeping and make all management decisions. Not all landlords can bare the risk of input cost or desire to have the responsibility of share renting cost and uncertainty.

No matter what type of lease is involved, remember that a lease, oral or in writing, is a contract and will be interpreted in the light of contract and lease law. For this reason, both parties must understand the details of their lease agreement and the language used in defining the terms of the lease. Many legal terms convey specific, established meanings, and it is important that these terms be used correctly. The Code of Virginia will determine certain parameters of the lease such as lien priorities and add provisions such as renewal date if not negotiated as part of the lease.

Leases can be simple, oral arrangements or complex, lengthy written instruments. Although the oral agreement may be legally enforceable, a written agreement is strongly suggested to spell out the details, avoid “selective recall” on the part of the landlord or tenant and future misunderstandings. As environmental issues may be involved, leasing standards should be explored and agreed upon.

The relationship between a landowner and the farm operator may be classified as a landlord-tenant relationship, an employee contract, or a partnership. How the relationship is classified depends on the provisions of the agreement. This publication is designed to encourage a landlord and tenant to carefully review their relationship to determine the best financial and physical arrangement for both parties. This publication is not designed to substitute for adequate legal counsel. Rather, it is designed to stimulate the landlord and tenant to raise the appropriate questions before they

meet with their lawyers. Legal ethics would not allow a lawyer to represent both parties in most situations. The land lord and the tenant have different interest on many issues.

III. Getting Started

Taking time to select a tenant or a landlord is the most important step. The relationship is often a long term one as both can gain from quality, stability, and trust of a long term leasing arrangement. Both should take time to explore farming practices, goals, and abilities of each party to the lease agreement.. There is no substitution for communication. The nature and type of contractual relationship should be detailed. This section explores the decisions that must be explored before you commit yourself to the lease. The authors are aware that many farm leases involve relatives , neighbors, and friends from religious institutions. These arrangements require more than casual reflections.

A. Selecting a Tenant

Finding the "right" person for a tenant will take careful and timely effort. Before considering available tenants, the landlord should write out his or her farming objectives and have a clear understanding of farming goals (Farm Lease Guide, Dunaway, Morrow, p.11). The landlord should keep in mind that a landlord-tenant relationship combines the resources of two persons (Your Farm Lease Contract, Farmers' Bulletin No. 2164, USDA, p.4). A tenant should be someone of mutual trust and with whom communication is easy. A landlord should question the potential tenant about his existing farming practices, financial stability and ability, quality of equipment, husbandry techniques and more. Is the tenant's management ability consistent with the landlord's ideals? Is the tenant innovative and progressive with his farm and willing to discuss farming practices,

comparing yields, equipment condition and conservation concerns? Which landlord's property gets worked first? (More important for share leases and less for cash rent) Does working the land on Sunday matter? Although, many arrangements are "all in the family," this does not diminish and perhaps enhances the need for a formal interview and selection process. Visiting with a tenant's spouse and family is important to get a feel for relationship stability. A landlord should discuss with a tenant whether the rented farm will be an added benefit or added burden to his existing farm operation. A landlord should ask the tenant for references. Visits should be made with references, including the prospective tenant's banker, to get an idea of the tenant's reputation and financial stability. As a result of thorough evaluation of a tenant, a landlord will be more satisfied with the way his land is operated and the income it generates (Farm Lease Guide, Dunaway, Morrow, pp. 12-17).

Some alternatives to a landlord selecting a tenant are: have a professional farm management firm evaluate tenants, hire a farm consultant, or obtain the advice of a qualified disinterested third party (Farm Lease Guide, Dunaway, Morrow, pp. 12-17).

- Employee or Tenant - A trap for the careless

At first, the difference between a tenant and an employee is easy to see. An employee is paid a wage to produce a crop. The wages are generally \$XX per hour. The wages could be paid in cash, paid in commodities or part commodities and part cash wages. The wages an employee receives may be a share of the crop or a share of the proceeds of the sale of the crop. The employee has no legal interest in the farm and usually no legal interest in the crops until they are set aside at harvest as part of his wages. In Virginia, an employee does not have a statutory lien

on the crops for the wages that he is due. The employee's sole remedy, if his employer fails to pay the wages, is to sue for damages for breach of employment contract.

A tenant, on the other hand, may be entitled to exclusive use and possession of the real estate during the term of the lease, based on the provisions of the agreement. Landlords access during the lease term should be discussed and spelled out in the leasing agreement. The tenant may sue other parties during the term of the lease for trespassing on the premises, including the landlord, unless stated otherwise in the lease. For example, hunting rights of the landlord and the landlords family and friends should be spelled out. Provisions for mutual review of tenants actions on the farm or proposed actions should be spelled out. For example, an annual discussion of crops that will be planted and where should be spelled out in the lease.

The crops, until divided, belong to the tenant exclusively even if the landlord is to receive a part of the crops as rent. As the operator of the real estate, the tenant is potentially liable in negligence cases for the injury of invitees or licensees who come onto the property, if injuries result from the poor upkeep of the premises. The tenant should anticipate such potential liability by obtaining liability insurance, with the landlord named as co-insured. Coverage should be obtained with a written binder from the insurance company.

A problem arises when a contract contains elements of both an employer-employee contract and a landlord-tenant lease. For example, a contract may use words such as "rentals" or "landlord-tenant," but if the lease provides for control of the operation by the landlord/owner, with the owner supplying the seed, fertilizer, machinery, and directing the

operation, a court may say the relationship is employer-employee instead of landlord-tenant. The rules that regulate the agreement may then turn out to be much different from the original intent of the parties. Careful drafting can avoid this type of litigation and conflict.

The distinction between a tenant and an employee is based on interest in land. A tenant acquires the right to exclusively use and possess the land during the lease but an employee has no such right. Income tax withholding, FICA and FUTA rules apply to wages paid to an employee. Commodity wages are not subject to FICA tax. In at least one case where the landowner provided the land, furnished cash advances to the sharecropper, and was in control of the operation, the court held the “tenant” cropper should be an employee. [Coward v. Barnes, 334 S.W. 2d 894 (Ark 1960)] The key was dominion and control or the right to direct the work and actions of the share cropper.

Generally, an agreement between an “owner” and an “operator”

creates a landlord-tenant relationship unless the intent is expressed otherwise. But oral agreements leave questions open to interpretation and unwise drafting can but the operator into an employee situation.

The distinction between a laborer (cropper) and a tenant is determined by the intention of the parties. If the intention is that the cultivator receive all or part compensation as a share of the crops, then he is a cropper (laborer). But if he is to have an estate in the land, paying a share of the crops as rent, he is a tenant. [Landlord-Tenant or Landowner-Cropper, 93ALR3d 1013-10C4.] The difference is determined by the facts. Words of rent, giving control of decisions as to what and when to plant all create a landlord-tenant relationship.

B. Selecting a Landlord

Landlord selection by a tenant is as important as other management

decisions. A tenant should decide whether the farm fits their needs and can be incorporated into his or her farming program. There are three basic steps that a tenant can use as a guide to evaluate a landlord.

1. Be satisfied that the prospective rental property fits your needs.

Rent a farm that is most suited to your enterprise(s). If you are a grain farmer, you may not want a lot of pasture. If you are a livestock farmer you may want to rent land with a large pasture acreage and less cropland. Determine if the rental property has adequate income potential to enhance your farming operation or whether you are just renting because the land is available and close. Check the reasons the farm is for rent. Perhaps it was unprofitable for the last tenant. Is the land part of a family feud or does the land belong to a retiring farmer or spouse of a deceased farmer. Determine land fertility and yield potential

and decide if your intended use is the best one for the soil capability. A renter should ask himself, will the added acreage economically optimize my equipment and labor or will it stretch my resources beyond capacity? Consider the farm location in relation to your other farms.

2. Get to know the landlord personally and from references. Is she or he the type of person you can work with as a tenant. Is the landlord the type of individual who will benefit you both? Be willing to visit with the landlord and share your farming views and ask about theirs. Consider whether the landlord is interested only in dollars generated versus conservation and modern environmental practices, cost sharing, and fertility build-up programs. Is the landlord reasonable and willing to give and take to negotiate a fair lease? Does the landlord have

an understanding of farming? Share with them your intended farming plan. Keep the landlord up-to-date on what you are doing throughout the year if you decide to rent the land.

3. Sell the landlord on your farming expertise and convince the landlord that you are the best person to farm the land. The best advertisement you can give is taking the landlord on a tour of your existing operation. Show him your farming records of past accomplishments and mention your goals. A cash flow budget impresses by showing how the additional rental unit will blend into the present situation. Most landlord like a modern, up-to-date tenant, one who understands technology and utilizes his resources well.

Once you have gone through this process, you will have created

a relationship in which the landlord feels good about you as a tenant, and you in turn feel comfortable about the landlord (Farm Lease Guide, Dunaway, Morrow, pp. 19-22).

- ***Partnership or Landlord/Tenant Relationship*** - A second trap for the unwary.

Legal problems may arise when the intent of the parties is not clearly expressed. A court may interpret the relationship to be a partnership when the parties intended the relationship to be a landlord-tenant arrangement. The importance lies in the fact that when a partnership exists, all partners are individually liable for all debts and obligations of the partnership. For example, the "tenant" can incur debts for which the "landlord" is liable if the "tenant" appears to be operating within the scope of the "partnership". Generally, a landlord does not wish to assume obligations of the tenant

arising from operation of the farming business. Therefore, it is important that a landlord-tenant relationship not be considered a partnership. Lease provisions usually spell this out. This can be a problem when the rental arrangement is within the family and the creditor is lead to believe parent and child are operating as one. By law, a partnership is formed when two or more act together with a profit motive. For example, Dad and Daughter plan to form a landlord-tenant relationship. Dad is helping Daughter get started in farming. Dad and Daughter visit the Farm Supply Store. The daughter purchase a 1000 pounds of fertilizer for her ½ and Dad does the same. The Supply manager asks Dad if all is on his account. Dad, knowing his Daughters limited financial circumstances says yes. Later, Daughter buys \$1000 worth of pesticide material. Although Dad and Daughter believe that they are Landlord and Tenant, the Supply store manager could argue that because Dad says yes to the fertilizer, they had formed a profit motive partnership. Supply manager could sue Dad for the \$\$\$ of

pesticides.

Because a partner has unlimited liability for all debts and obligation of the partnership, care must be made in creating the agreement. Creditor's may try to make the arrangement a partnership to secure payment of tenants unpaid debts. A well constructed farm lease should contain a provision stating that no partnership is intended to be created and that no liabilities are assumed on behalf of either the landlord or tenant. Such a clause serves as an expression of intent, but may not be finding on third parties. If landlords and tenants undertake Joint Control and profit sharing and act as if they "intend to carry on a business as co-owners", then a third party might be able argue the relationship is a partnership. Careful drafting

and actions under either a written or oral share-lease agreement must establish that but rather arises out of a contractual return to land and a separate farm business and payments in lieu of rent are not a “Joint profit and loss” activity. Paper records of expenditure on behalf of either the landlord or tenant for the opposite party should indicate who has the duty to pay and indication of reimbursement for expenditures on behalf of the other party.

The following chart contains a limited suggestion of questions and issues that a landlord and tenant should consider as they develop their agreement. As either a landlord or tenant, you should draft additional questions for your tenant or landlord.

CHART 1

Document that landlord or tenant might ask for from tenant or landlord when negotiating a lease.

1. Resume - Tenants background, experience, list of references, list of prior/current landlords.
2. Map of Fields/Past/Proposed cropping plans.
3. Appropriate current or proposed ASCS/Conservation plans for the property.
4. Insurance policies/provisions for assuring liability coverage.
5. Record of pollution problems on property or resolution of prior pollution problems by landlord or tenant.
6. A financial statement from the tenant.
7. An explanation of who has the hunting rights during the term of the lease.
8. Who will maintain the fences?
9. What practices are expected with respect to pasture management?
10. What is the availability of and rights to water for crop irrigation and cattle?
11. Can unneeded pasture land, buildings be sublet?
12. What are the pH and soil fertility levels? How are they to be maintained?
13. Who is responsible for liming the fields...both spreading of the lime and paying for the lime?

14. Are genetically modified seed allowed to be used?
15. What were the past herbicides and pesticides used on the land?
16. What type of herbicides, pesticides, rodenticides, etc are allowed.
17. Are there organic practices that are to be followed?
18. What are expected tillage practices for the soil.

C. Written vs. Oral Lease

A good farm lease contains complete, but flexible plans for operating a given acreage for a given period of time. It specifies management decisions, performance standards, expense sharing, the amount of rental payment, termination date or removal time, and other items. [Your Farm Lease Contract, Farmers Bulletin No. 2164, USDA p. 3].

Oral leases tend to create less than a satisfactory working relationship between parties because of the uncertainty presented. Amount of rent

and time of payment, along with the length of a lease, are usually clear in an oral agreement. And yet selective recall, death of an individual and time reduce mutual and positive understanding of lease terms. Arguments arise and friendships sever when unexpected expenses arise or parties no longer agree on the terms of the lease.. .

In rental negotiations, neither the landlord nor the tenant should consider anything less than a written contract. This provides protection for both parties as well as constituting a sound business practice. One common misconception is that if either of the parties, who have known each other for years, asks for a written lease, an element of distrust is conveyed. In reality, both should desire a written lease but neither may have the nerve to suggest it. At least, termination dates, type of lease, who pays what bills, level of husbandry or crop standards and the financial terms should be spelled out on paper.

Some advantages that a written lease has over an oral lease are as follows:

- A written lease prevents selective recall. People have tendencies to recall only those aspects of an agreement that benefit them. It provides a point of reference in case either party is in doubt about a detailed agreement.
- If case either party dies, it protects the rights of the heirs and provides a legal document for negotiation.
- A written agreement provides a bench mark from which to change minor provisions of the lease. For example, weather conditions may prevent ground application of chemicals and

aerial spraying may be too expensive for the tenant to pay alone, so the cost can be negotiated and shared between both parties.

- Both parties in a written lease are forced to carefully consider all aspects of the lease, since they must officially sign the contract.
- If the agreement specifies the details of the farm, it will serve as a record of the farm operation. Thus, in the case of dispute, it will prevent common law, court decisions, or local custom from determining the application of practices or procedures that may not be well adapted to the farm. It can also serve as a reminder of lease provisions that worked well and those that did not.
- The written lease makes the period of rental definite, and

provides a basis for continuing the terms beyond the current term. It also provides an opportunity to define a reasonable period of notice after which a lease may be terminated. For example, a period longer than a year maybe needed for the landlord or tenant to recover cost of improvements on the property. Needed conservation investments may need extra time for conscious tenant to recover costs.

- The concerned landlord can use a written lease, with clearly stated farming guidelines, to include conservation provisions and successfully bring legal action against the tenant in the event that the lease is breached. Tenants who display good land stewardship can benefit from a detailed written lease by severely limiting exposure to environmental liabilities.

- When you consider the arguments that can be raised concerning leasing responsibilities, the advantage of using a written lease as opposed to an oral one should be obvious. A four or five page lease cannot cover all the possible conditions that might develop and does not guarantee a perfect landlord-tenant relationship. But it does set a framework to clarify procedures, delegate responsibilities and resolve differences.

[Farm Lease Guide, Dunaway, Morrow, pp. 19-22.]

IV. Legal Aspects of a Lease Agreement

This section will provide the landlord and tenant information about situations and cases governing leases.

A. Law of Leases

A written or oral lease is a contract. It should be approached with the same careful and thorough consideration given any legal and binding

contractual agreement. Most states, including Virginia, have enacted the “*statue of frauds*” which details the types of contracts which must be in writing to be enforceable.

The *statute of frauds* provides that no legal action can be brought upon any oral agreement that is not to be performed within a year. The measuring term for the lease is from the date the lease starts and not from the date of agreement. (Va. Code Ann., § 11-2.) This includes any contract for the sale of real estate or for the lease of real estate for a period of more than one year, unless the contractual agreement is in writing and signed by the party who is being sued or signed by his agent. For example, assume there is an oral agreement to lease property for a three-year period, but the tenant decides to terminate the lease. The landlord may not enforce his agreement because the lease term extended beyond the one year limitation. In short, an oral lease for a term of more than one year cannot

be enforced by the courts. There are exceptions to the statute of frauds where for example, one party starts performing on the contract. If Lana Landlord and Ted Tenant enter into a two year oral agreement and Ted harvests one crop and tills the soil for a second crop, he has performed under the contract and the court is likely to enforce the agreement based upon the doctrine of part performance. Part performance takes the contract outside the limitations of the Statute of Frauds.

The writing required under this section does not have to be a detailed contract. A memorandum or note is sufficient if it is signed by the party being sued or signed by his or her agent. Various written communications have been found to comply with the statute, such as notes on separate pieces of paper, letters, telegrams, and other types of writings which serve as memoranda of the agreement. However, a more detailed writing is obviously preferable to a short note.

Virginia law provides that certain contracts not in writing are void as to purchasers or creditors who have no notice of the contract. (Va. Code Ann., § 11-1.) An oral contract for the lease of real estate for a term of more than five years is void with respect to any innocent third party purchasers or creditors unless the lease of 5 years or more is filed with the land records in the court house. (Id.) For example, if a lease for a period of over five years is not in writing and filed in the court house, a potential purchaser has no notice of the lease. If Teddy Tenant is in the 3rd year of the agreement and Billy Buyer purchase the farm from Lydia Landlord, Teddy loses any rights under the lease. On the other hand, if the lease is filled in the court house, Billy Buyer takes the land subject to Teddy Tenant's rights in the land. Any lease of more than five years must be filed with the real estate records to be effective against third party purchasers. The tenant would not be able to hold the new owner to the lease and the tenant may have to vacate the premises. Similarly, if a landlord has

creditors who are not aware of the existence of an oral lease arrangement, the creditors might be able to attach the rented property and the tenant would have no recourse. This requirement of Virginia law makes it essential that leases be in writing to be valid as against claims and rights of innocent third parties who acquire some interest in the property.

Be sure that both owners of land sign the agreement or orally agree to the renting of the property. For example if Jack and Jill Farmer jointly own the real estate as tenants in common, tenants by the entirety or joint tenants and only Jack signs the lease, Jill can rent her half to someone else. Jack's signature only covers his interest.

B. Notice Requirements

An oral lease for a one-year period or longer is considered to be a *"tenancy from year to year"* under Virginia law. Such a lease may be

terminated by either party giving notice in writing three months prior to the end of the lease year. (Va. Code Ann., § 55-222.) **Failure to give notice on the part of either party 3 months in advance will result in the continuation of the lease for another year.** Many oral leases of farm property fit the classification of a *tenancy from year to year* because the parties contemplate a right in the tenant for at least a one year period. (Often from January 1 to December 31) However, if the contract is oral, the parties might not recall the term of the contract. Was the contract from March 1 to Feb 28 or January 1 to December 31? Was the contract for a year or a crop year? If the contract is for a year, the termination by either party is 3 months before the end of the contract. October 1 or December 1 in the two examples above would be the appropriate date be both the landlord or the tenant. Even a memorandum signed by both parties stating the date of the lease is a minimum requirement. By writing, both parties could change the termination notice date to a date other than 3 months

before the end of the lease. For example, by writing, the parties could agree that the term of the lease is January 1 to December 31 with a notification date of December 1.

If, in fact, the parties do not contemplate that the lease will run for a period of a year, then it may be considered a "*tenancy from month to month*" in which a thirty-day written notice prior to the end of the month is necessary to terminate the tenancy. (Id.) The third type of tenancy provided by Virginia law is referred to as a "*tenancy at will.*" A *tenancy at will* may be terminated at pleasure by either party. Tenancies at will and month to month tenancies are not practical for most agricultural purposes. However, some farmers enter into *crop-year leases* that cover only the portion of the year that the crop will be in the ground such as May to October. Neither statutory or case law provides the notice requirement for such a lease. Thus, if a tenant enters into a crop lease, they should have

written dates for the beginning of the lease, ending of the lease and renewal date. Although an argument for that a three month notice for termination or continuance of a crop lease would be appropriate, (like a year to year tenancy) , the best solution is to put it in writing.

Naturally, the various tenancy and notice requirements do not apply if the agreement itself is in writing and provides that the tenancy will end at a certain time or if it specifies no notice is to be given. At the same time, the agreement between the parties may provide other notice requirements, and these will be enforceable if they are a part of a written agreement.

(Id.) In our judgment, every farm lease should at least be affirmed with a written date of when it begins and when it ends coupled with a date by which either party must notify the other party of continuance or discontinuance.

Notice to the tenant may be served directly on him or anyone who is holding under him as a sub-tenant. A notice to the landlord may be to anyone who owns the premises in whole or part, or an agent of such person.

None of the specified tenancies automatically extend against the tenant for another term by the failure of the tenant to vacate at the end of the lease term. (Va. Code Ann., § 55-223.) The tenant is liable for any use or any losses or damage sustained by the landlord due to the failure to surrender the premises upon the agreed upon date or the date terminating the lease by law. (Id.) Again, details concerning these items may be specified in a written agreement and should be included so that it is clear to both parties what their rights and obligations are.

C. Rent and the Landlord's Lien

Generally, a written contract should detail the rights of either party in case of a breach of the contractual arrangement. Normally, leases include provisions for the right of the landlord to re-take possession upon the failure of the tenant to pay rent as due. In those cases where these rights are *not detailed by agreement*, the law provides procedures for the collection of rent. Although these provisions include specific items relating to the tenant's rights, these provisions are specifically written to provide the landlord with alternative ways of collecting rent and re-taking possession of the premises in the event of non-performance of rent or other contractual duties.

Historically, Virginia law specifically authorized the landlord to re-take the premises at any time if the tenant deserts the premises leaving rent due and unpaid. (Va. Code Ann., §§ 55-227, et seq.) In specific situations

(where there are no goods of the tenant left on the property and no cultivated crops left growing) the landlord could post notices on the premises. After a period of ten days from the posting for a month-to-month tenancy, or one month for a year-to-year tenancy, the tenant's rights cease and the landlord may re-enter. But, by written agreement, a farm landlord could acquire right to re-enter earlier. For example, if the agreement said, "if the tenant has not planted crops by X date, landlord may re-lease the premises," the landlord could protect the investment by finding another tenant and not waiting 9 months for the right to plant or take possession of the property..

(we need to carefully review and write this up in light of amendments to the uniform commercial code.

In a more typical situation, the tenant remains on the premises and is in default for non-payment of rent. In such circumstances the landlord possesses a number of options. The landlord may file an action in court

against the tenant in order to attempt to collect the rent. Virginia law provides a substitute procedure that is commonly called "distress for rent." Basically, this procedure permits the landlord to obtain a distress warrant from a judge or clerk of the District Court upon affidavit of the landlord that rent is due. The warrant authorizes the sheriff to levy upon any goods of the tenant found on the leased premises and/or which have been removed from the premises for not more than thirty days from the time of payment default. This levy may be made to the extent necessary to satisfy the rent due. The sheriff, in effect, attaches the tenant's property and holds it until such time as proper orders of a court are entered regarding the disposal of the property and the payment of the rent. Again, we have the harvesting and storage problem with agricultural commodities. Under these provisions, the landlord acquires a lien (created by statute) on the property of the tenant which relates back to the time that the tenancy commenced, but is only effective for the amount of six-month's rent for residential

property or twelve-month's rent for farm and agricultural property. (Va. Code Ann., § 55-238.) The lien applies to goods which are not subject to any prior liens at the time they were brought onto the premises. This provision is problematic on the farm as the tenant's goods often are only the growing crop. Without harvesting equipment, time may render tenant's "goods" valueless. A second problem is that the farm crop may have been pledged to a lender who provided seeds and fertilizer, (See following section)

Under the distress proceeding, the landlord is allowed to take possession of the lease property only upon court order. Such an order will not be entered lightly. For example, the tenant will normally be given reasonable notice and an opportunity for a hearing and has a right to post a bond and retain possession of the property until after the hearing. The landlord must clearly establish that his claim is valid and that there are

no defenses likely to be raised by the tenant. A hearing may not be necessary if a written waiver of the right to hearing is signed by the tenant prior to the taking of possession. Therefore, some leases include such a waiver in order to expedite the process should rent be due and unpaid and should the landlord wish to re-take possession.

Special provisions cover those situations in which the rent due was to have been paid in a *share of the crop*. If rent is due, ten day's notice may be given to the tenant, or a notice posted on the premises if the tenant is out of the country, and the landlord may then ask the court to order the sale of the crop and to ascertain the value of the rent in money. The recovery of rent extends only to the value of produce or goods up to the amount of rent due, plus a severance charge.

All of these provisions allow the landlord a specific landlord's lien

upon goods or property on the leased premises by operation of law.

D. The Landlord's Lien and Article 9

The agreement between the parties determine the nature, amount and date of rent or share payments. In the absence of an express provision for payment, the general rule for a year to year or term lease (crop season lease) is at the end of the year term and at harvest or a reasonable time after harvest for a crop-share lease. Appropriate delivery place for landlords share should be in lease or it will be at leased premises.

Under Virginia law, the landlord has a security interest in goods subject to the amount of the unpaid rent. The landlord becomes a creditor of his tenant by virtue of his rental contract, oral or written. A landlord's lien is fixed and specifically exists independent of the right of distress or

attachment. [John Deskins Pic Pac, Inc. V. Flat Top National Bank, 59 Bankr. 809 (Bankr. W.D. Va. 1986)]. A statutory lien, which arises at the creation of the tenancy or date of lease agreement and is enforceable in the courts, protects the landlord against all deeds of trusts, mortgages, and other liens of the tenant if a tenant fails to pay rent and the lease agreement is severed. This statutory landlord's lien takes precedence over any lien of any other person obtained or created upon the goods or farm products, including Article 9 liens, (Secured Transactions Lien, Uniform Commercial Code), on the leased premises after the commencement of the tenancy. Any such liens that were sanctioned before the tenancy was created are still valid, but the landlord's lien had priority in recovering unpaid rent from a tenant. (Id.) Today, when farmers borrow money to finance crops and livestock, they are financed under the Uniform Commercial Code, Article 9 liens (Historically such liens were called *chattel mortgages*). Today, liens for operating loans are filled on a UCC1 and filed centrally with the State

Corporation Commission. (Liens for fixtures such as a poultry barn are filed locally with the real estate records.) An Article 9 lien is the farmer borrows money from a lender for seed, fertilizer, equipment, etc. and the lender takes a security interest in the farmer's production of grains and livestock. The agreement (security note) is signed by lender and borrower. A UCC 1 is called a *financing statement* and gives notice to all that the farmer has borrowed money on the crop, livestock, equipment or building. The UCC 1 is filed centrally or at the court house. These loans are called production loans as compared to real estate loans. Real estate loans are secured by a pledge of land and the filing of a deed of trust (mortgage). If the tenant borrows money to produce the crop, who has rights to the crop...the lender of the seed and fertilizer or the landlord.

Historically, the landlord's statutory lien (created by Statute in favor of the landlord) gave priority to a landlord's statutory lien over other lenders. In *Dean v. Hall* (Dean v.Hall 2003 WL21650145, 2003 Lexis 12720,

E.D. VA. 2003) the court held that a Lien claim filed under UCC Article 9 (UCC 1) is superior to the Virginia statutory landlord's lien on agricultural products. To secure the landlords priority in the crops grown on there premises, the landlord must file a UCC1 just as any other farm lender does or secure payment of the rent before the land is cultivated.

(this should be moved to a distress section and amplified. The distress proceeding and enforcement of the landlord's lien can be rather complicated and should not be attempted without the advice of legal counsel.

Revise

See Table A for a comparison of types of lien.

Creation of Lien	Type of Lien	Type of Collateral	Documents		Type of Law
			Creating Interest	Filed in Court House	
Statutory	Real Estate Taxes Not Paid	Real Estate	By Law Automatic Upon Default	By Law When Not Paid	
	Landlords for Rent	Tenant's Crops/livestock Equipment <u>on</u> land	By Law Automatic	Enforced By Distress or Court Action	
Voluntary	Mortgage or Dead of Trust	Land, Buildings	Deed Of Trust Note	Deed of Trust	Real Estate Loan
	Secured Transaction	Equipment, Farm Products, Live Stock, Fertilizer	Security Agreement	Financing Statement	Production Loan

Recordation, in the county or city where the real property is located, of any instrument granting, transferring or acquiring the interest of the

grantor, transferor, acquirer, pledger or leaser in leases, rents, or profits arising from the described real property fully perfects the lease ***(ed. note: look this up)** as to the assignor and all third parties (Va. Code Ann., § 55-220.1).

Because the lien is effective as of the beginning of the lease it will be superior to other liens. In fact, in some states it is described as a superior lien in all events and will prevail even over a prior perfected security interest of a lender under the Uniform Commercial Code (UCC). Priority conflicts between the holder of a perfected security interest in the crops under UCC Article 9 and the landlord are resolved outside the UCC.

Although the landlord's lien is superior to most other liens and claims, if the tenant sells the crop to a bona fide purchaser who is without notice of the landlord's lien, the buyer takes free of the landlord's lien. However, in the typical marketing situation the purchaser will be a local cooperative or private elevator which is likely to be aware of landlord-tenant relationships in the area. This "common knowledge" of landlord-tenant relationships may serve as sufficient notice to purchasers to negate any claims that the purchaser was bona fide and without notice. This is another reason for a landlord to file a UCC 1 lien.

The landlord may also waive the lien either expressly or by implication. An express waiver may appear in the lease agreement especially if the tenant's financing is obtained from Farmers Home

Administration or the Farm Credit System. Their standard lease form contains such a waiver as do those provided by some other lenders. Waiver by implication, in some jurisdictions, may occur if the landlord does not object to the sale of crops. Further, some states require that the landlord's lien must be recorded to be effective. In all cases, it is necessary for the landlord to take some action, usually in court, to enforce the lien.

Another disadvantage of relying on the statutory landlord's lien, from the landlord's perspective, is that it may be avoided if the tenant files bankruptcy. In those cases, the landlord will not take a priority position but will be treated as a general unsecured creditor.

(I may have pulled this from somewhere... we need to check and make it cited or edited without knowledge.)

III. ARTICLE 9 SECURITY INTEREST

It is possible for a landlord to take a security interest in crops pursuant to UCC Article 9. If handled properly this method may provide additional protection for the landlord. In fact, it has been suggested that the landlord's lien may be preserved while taking a security interest at the same time if specific language is added to the lease indicating that waiver of the lien is not intended.

In order to use this procedure, the landlord must use a security agreement which adequately describes the property, in the same way that a lender obtains a security interest in crops. A financing statement must also be properly filed to give notice of the existence of the security financing statement must also be properly filed to give notice of the existence of the security interest. The priority position of the landlord will depend not on the date the lease commences but on the date the security interest is properly perfected by filing.

Conflicts with other secured creditors will be resolved on the basis of filing dates. This interest, unlike the landlord's lien, will survive a bankruptcy and, if properly drafted, will extend to the proceeds from the sale of the crops.

The Food Security Act of 1985 (farm bill) contains special requirements that must be met by holders of security interests in farm products in order to protect against the rights of purchasers of those products. For the interest to continue in the farm products following sale, the "lender" (holder of the security interest) must either provide direct notice to potential buyers or must file a special notice in a central office. The exact requirement depends on which option a particular state has adopted.

Thus, to use the Article 9 procedure, and to be protected at sale, the landlord must follow several formal steps to be assured that this procedure is effective. While it may strengthen the security for rent, it does require more observation of legal formalities than reliance on the landlord's lien. [J.W. Looney, "Farm Leasing Arrangements: Tenant's Default and Methods for Security of Rent." Producers Bulletin. No. 27 April 1993.]

Although the landlord's lien is superior to most other liens and claims, if the tenant sells the crop to a bona fide purchaser, without notice of the landlord's lien, the buyer takes free of the lien. However, in the typical marketing situation the purchaser will be a local cooperative or private elevator which is likely to be aware of landlord-tenant relationships in the area. Local cooperatives often make it a practice to check records for liens against their members. Where tenants are securing crop financing from agricultural lenders such as the Farmers Home Administration or Farm Credit System these lenders will also have a security arrangement in which they may

seek the subordination of the landlord's lien. These lenders typically will inform potential purchasers of their interest. This "common knowledge" of landlord-tenant relationships may serve as sufficient notice to purchasers to negate any claims that the purchaser was bona fide, without notice.

It is possible for the landlord to waive the lien either expressly or by implication. By statute, the landlord's lien may be waived in favor of the lien of the tenant's employees if done by written consent in a written employment agreement. The landlord's lien may also be waived, in part or full, in favor of the rights of a mortgagee if the waiver is recited in the mortgage or attached thereto.

Waiver may also occur by actions of the landlord evidencing an intent to waive the lien. The presumption is against waiver so the existence of intent must be "express or very plain and clear." Because financing arrangements of the tenant may call for a waiver or subordination of the landlord's lien, this item should be addressed as part of the lease agreement.

Under a crop-share lease the interest of the landlord through the lien upon the crop goes only to the amount or share due as rent. It ripens into "ownership" only upon maturity of the crop. The landlord could grant a security interest in this interest by the lender would be able to reach only the landlord's share in the crop maturity. [J.W. Looney, "Farm Leasing Arrangements and the Doctrine of Emblements," National Center for Agricultural Law and Information, Producers Bulletin. No. 26, April 1993.]

E. Rights and Duties of the Landlord and Tenant

1. Duties, landowners, tenants, and *those who enter* the land.

Disputes sometimes arise regarding the use the tenant makes of the property while in possession. Written leases which detail the rights and duties of the tenant regarding the care of the leased property while in possession reduce such disputes. One should include as part of the lease agreement details regarding authorized uses the tenant can make of the property and the standard of care expected in these uses.

The most common tort liability that arises between landlords and tenants include 1) liability for injuries incurred by the tenant or the tenant's invitees or licensees due to defective or dangerous conditions on the property; 2) liability for the spread of a contagious disease by landlord or tenant; 3) damages to or destruction of buildings; 4) waste; 5) soil and other resource destruction; 6) spray or drift; and 7) other

environmental damage.

The basis common law tort of nuisance, negligence, trespass are applicable in many of the landlord tenant transactions. At common law, a lease is the equivalent of the “sale” of the land for the term of the lease. The landlord has a reversionary interest and the tenant or “owner for the term” assumes the responsibility for the property; maintenance and activities on the property. Although statutory provisions such as the Right to Farm Act may reduce or illuminate liability for selected activities, they are not bullet proof provisions. And, it may cost a lot to enforce your rights. Insurance provides both a duty of the company to protect you as well as protection if you are found responsible for a nuisance, negligence or trespass

Premises liability as discussed below is another reason to have a

carefully drafted lease. The lease should spell out who is responsible for which activities, who is responsible to cover which activities with insurance, a method to assure that the other party is notified that the activity is covered with insurance and a standard of care for the activities.

Nuisance is another area for concern of the landlord and tenant. Livestock operation lead themselves more easily to the creation of a nuisance. But chemical sprays may also give rise to a nuisance. A nuisance is defined by law as the use of ones property which causes an *unreasonable* interference with another's use and enjoyment of their property. The person responsible for the premises such as the tenant is liable for a nuisance created or maintained on the premises.

Nuisance is the imposition of liability as the result of an act or omission whereby a person is annoyed, prejudiced, or disturbed in the

enjoyment of land. It may be physical damage to the land or the imposition of discomfort upon the occupier of the land. [Salmond and Heustai; Law of Torts, 20th ed. 1992 p.57]

Another area of potential liability is for a trespass caused by the operator of a farm. A trespass is a physical invasion of a another's property. (should be not para)The tort of trespass to land consists in the act of 1) entering upon land in the possession of another, or 2) remaining upon such land, or 3) placing or projecting any object upon it-in each case without lawful justification.

A third area of potential tort law is negligence. Negligence is conduct (an act or omission) which involves unreasonably a great risk causing injury. An Individual is negligent if they fail to conduct themselves as an "ordinary and reasonable" person would under the circumstances. An individual is

liable if they breach the duty owed another and as a result of that breach, the other party is damaged. The duty owed must be reasonable and foreseeable.

A landlord must protect farm customers and employees from unreasonable risks while they are on the farm property. Once land is rented to a tenant, the obligation of protecting employees and customers from unreasonable risk transfers to the tenant. However, the landlord must inform the tenant of any dangers on the farm that are not obvious. Any landlord or tenant who fails to fulfill their obligations commit negligence and is liable for their actions.

Negligence (careless acts or failures to act) may result in large damage suits. Negligence may cause financial ruin. The liability of a farmer who is engaged in a contract likely arises from negligence in the following areas:

(1) personal actions; (2) trespass or injury by livestock; (3) negligent acts of employees, in the course of their employment that result in injury to others; (4) injury to employees arising from personal actions, defective machinery or equipment, or defective conditions on the premises; (5) the condition of the premises with respect to the customer (business invitees); (6) defective or contaminated products; or (7) environmental hazards.

A person who commits a negligent act (tort) that results in injury to another may be liable for the harm caused by that negligence. The violation of a duty may result from a failure to act or exercise the degree of care that an ordinary, reasonable, and prudent farmer would have taken under the circumstances or the situation.

Negligence is measured by the Jury as the conduct of any individual, in a given situation, depending upon his:

a. Judgment ; b. Knowledge, perception, and experience; c. Skill;d.
Physical, mental, emotional characteristics; and e. Age and sanity.

Therefore, the general rule holds that if a reasonable man could anticipate any injury from his negligent act, he may be held responsible for all the direct consequences. This rule applies even if he could not foresee the precise type or extent of the harm. That is, your liability for the consequences of your act or failure to act is based on the fact that you should have foreseen that some possible injuries could result. If you allow Junior to play on the tractor and he releases the brake and the tractor runs over his sister's playmate, you are liable for the friend's broken leg. The liability is based on negligence and the indirect but foreseeable nature of the harm.

People or businesses who own or lease property are required (duty)

to maintain it in such a condition that others are not put in bodily danger or fear when they enter upon the land. The duty owed to an entrant upon the land leased or owned (controlled) by a business or individual (controller) depends upon the status of the individual entrant under the law. Under the common law as adopted by Virginia and many other states, individuals entering the land of another are divided into three classes based on status: trespassers, licensees, and invitees. When negotiating a lease, discuss which "negligent actions" may arise. The parties must memorialize such discussions in written contractual form when the lease is made. At common law, the landlord generally escapes liability for injuries arising from a latent defect or dangerous concealed condition existing at the time the lease was signed. Modern courts recognize five exceptions to the common law rule as follows:

- a. Concealment by the lessor of latent defects or dangerous

conditions;

b. Conditions dangerous to persons outside of the premises;

c. Premises leased for admission of the public;

d. Parts of land retained in the lessor's control which the lessee is entitled to use;

e. Express covenants by the lessor to repair the leased premises.

A farmer may transfer the risk of loss due to negligence to an insurer. Generally, both the landlord and tenant should have insurance against those risks which they are unwilling to assume. Therefore, landlords and tenants should maintain liability insurance. The amount of coverage your

insurance policy provides should be determined with care. Too much insurance is an unnecessary expense, but too little insurance may result in damage payments from which your farm business might not recover.

Most farmers maintain insurance coverage, but problems arise if the policy amount is inadequate or fails to cover certain activities, such as direct marketing of farm products either from the farm, leased farm or farmers market. Many farm-owner policies do not cover bodily injury or property damage arising out of business pursuits on the farm other than farming. Activities such as direct marketing on the land or leased land may require a business policy. Who is responsible and for what activities should be spelled out in the lease. Make sure that your insurance coverage is *in writing*.

Remember, you can reduce liability by adopting the reasonable-and-

prudent-person concept and remove danger from the leased premises.

However, the nature of your leasing operations likely changes your insurance needs. Make sure that all of your potential liabilities to business invitees and workers are insured; and make sure that all explanations, additions, and corrections to your insurance policy are stated in writing.

[How to Avoid Lawsuits For Negligence, A Primer for Direct Marketing Farmers, L. L. Geyer, pp. 21-22.]

A landlord under certain circumstances may be liable to injuries sustained by the tenant and a third party who enters the premises. The general rule is that a landlord as the lessor may be held liable for injuries sustained by the tenant or patron of the tenant (lessee) as a result of landlords failure to act. A defective condition of the premises where the landlord, although aware of the defective condition, concealed or failed to disclose the condition. For example:

- maintaining a nuisance on the premise which causes injury
- maintain control over portions of the premises, or
- where landlord was negligent in making repairs or improvements to the premises.

[Business Patron, Landlord's Liability, 17 AR 3d 422-481, see also Tenant's Vicious Animals, 87 ALR 4th 1004-1079; Landlord-Strict Liability, 48ALR 4th 638-649]

And, a tenant who has control of the leased premises may be found liable for injuries or damages suffered or sustained as a result of the condition of the premises. This common law liability is based upon the tenant's negligence in misusing the premises; because the tenant has created, or allowed the creation of, a nuisance in the premises; or the tenants failure to perform a duty to make the premises safe for invitees.

[Tort Liability Based on Tenant's Covenants, 44ARL3d 943-950].

The landlord-tenant relationship inherently contains a conflict of interest. On the one hand, the tenant desires to obtain maximum profits for his work in the short run, while the landlord's interest is to preserve the fertility and the quality of his land in the long run. Both the landlord and the tenant must detail the duties of each party towards the upkeep of the land; otherwise, those duties may prove unenforceable in court.

For instance, before a tenant makes capital improvements to the land, he must realize that the landlord is not required to reimburse the tenant for his expenses unless so agreed in the lease. For this reason, tenants may be unwilling to make any capital improvements to the land under an oral lease. A good written lease allocates these costs. For example, the parties could agree that the landlord supply the materials and the tenant would keep the fence in good repair.

2. Duty Not to Commit Waste

Another potential conflict arises over the duty of the tenant not to commit waste. Virginia law imposes liability upon the tenant for damages if he commits wastes while in possession of the property. (Va. Code Ann., §§ 55-211, et seq.) The Virginia law sets the damages at two times the value of the actual damages if the waste is wanton. (reckless or intentional) (Id.) Waste committed during the tendency of any law suit may be considered contempt of court and triple damages may be assessed (Id.)

Today, the term "waste" lacks precise definition. What practices are considered wasteful to the real estate? Proving waste most commonly requires a finding of "permanent" or "substantial" injury to the real estate. With regard to poor soil practices, the problem of proving the decline in value of the land arises. A soil test could establish a base line with the

requirement that that tenant would return the land at a similar standard of soil fertility.

Courts draw a distinction between two types of waste. The law defines "*voluntary waste*" as waste resulting from an action, such as removing topsoil, destroying buildings or fences, cutting or selling timber, or destroying shrubbery or other cover. *Permissive waste*, on the other hand, results from a failure to do something, such as a failure to rotate crops, contour plow or plant a cover crop.

Although ill-defined, courts distinguish between *voluntary waste* and *permissive waste*. Injunctions have been granted against injurious acts of tenants, such as pasturing cattle on wet ground, over tilling soil and removing topsoil. But when permissive waste is involved, the ill effects result from what has not been done, and hence, there is nothing to enjoin.

And, damages could be hard to prove. For example, courts have held in favor of tenants in cases where they have used poor conservation practices, such as permitting land formerly in cultivation to lie fallow or grow up in pine trees, or allowing land to grow up in weeds and go uncultivated. In short, common law remedies prove ineffective in preventing permissive waste by tenants, and little legal recourse exists. Where a tenant leased 114 acres of tillable land but only planted 35 acres, the court awarded damages to the landlord based on the tenant's failure to cultivate the land by the usual and customary methods prevailing for small grains. [Arkansas Rural Rehabilitation Corporation v. Longino, 95 S.W. 2d 97 (Ark. 1936)]

Courts define waste on a case-by-case basis. Removal of top soil, cutting and sale of timber, destruction of buildings and fences, , failure to rotate crops, failure to plant a cover crop, creating soil compaction , overloading of barns, removal of manure and method of plowing have been

considered waste. [Hail, Agricultural Law § 8.04 [4]] Failure to properly dispose of chicken manure or proper disposal of diseased animals could be considered waste and require monetary damages for the landlord. In addition to court cases, statutes protect the property by prohibiting the tenant from taking any action which would be permanently damaging to the real estate. Although a number of things qualify as waste under the statute, Virginia law prohibits the removal or sale of manure from leased premises. [Va. Code Ann., § 55-215.]

This issue may make little sense in the case of poultry or hog manure under today's commercial standards and/ or environmental requirements. Under the statute, manure made in the ordinary course of husbandry includes: ashes; collections from stables, barnyards, cattle pens or other places on the leased premises; or composts formed by a mixture of any of these with soil or other substances. [Id.]

In addition to these statutory remedies, a court of equity may prohibit waste. [Chosar Corp. v. Owens, 235 Va. 660 370 S.E. 2nd 305 (1988).]

Namely, the court may issue an injunction prohibiting waste. [Id.]

For the landlord's protection and the tenant's protection, specific provisions should be included in the rental agreement detailing what acts are permissible and what acts are expected as part of the normal course of husbandry.

3. Environment, Waste, and Modern Tort Issues of Landlord and Tenant

The problem of waste should be discussed in bargaining for the lease and the lease documents. An expressed covenant that tenant will follow “good cropping practices,” certain management practices, a particular tillage system, sustainable agricultural practices, environmental standards may be appropriate. Spelled out duties that the tenant must follow to

avoid practices that could increase soil erosion over and above that caused by reasonable use. Similarly standards of soil fertility, pesticide and herbicides use could be defined.

Whether or not courts would adapt an implied covenant of “good stewardship” and hold that a tenant has committed “waste” for causing soil loss is speculative at this stage. In states where the duty of the tenant to prevent a waste is strongly supported, the court could/should recognize poor farming practices do cause economic harm. The landlords best defense is to a) put specific provision in the lease and b) use short term leases to dismiss a tenant who commits “waste”.

Spray drift has been the source of litigation. Liability for damage to a neighboring landowner has been held under the theories of negligence, nuisance, and trespass. Other areas of concern are livestock operations

that may create offensive odors, pollute the water and land, provide a place for fly's to breed and other concerns. The Right To Farm law may not shield all of these activities. The landowner/ lessor might have reason to secure the use of land during the tenancy do to mineral exploration.

Allocation of cost to the tenant should be discussed. Standards should be discussed, maintained and agreed upon so as not to impair good relationships between the landlord, tenant, and neighboring property owner.

Modern leases should include provisions about how the land is to be used and the appropriate standard of care and usage of soil, fertilizer, lime, herbicides, insecticides, and other economic poisons, care of perennials, grasses, pasture lands. Rights and duties of landlord and tenant with respect to transportation, storage, use and disposal of chemical on the leased premises should be agreed upon. Appropriate clauses regarding the

following should be drafted for the lease.

- Location of chemicals, oil, gasoline storage tanks and other chemical hazard sites on the land. (sink holes used to dump herbicide, creosote and other chemicals, sheep dip sites, underground storage tank and hose).
- Agreement by landlord to hold tenant harmless for current toxic and hazardous sites.
- Agreement by tenant to reimburse landlord for any spills, improper storage of toxic and hazardous materials.
- Agreement by tenant to notify the landlord and appropriate regulatory officials if a spill or other accident involving chemicals happens.
- Agreement on if, when, and where any chemicals may be stored on landlords property and how such chemicals will be secured and how environmental damage will be prevented.

- A warranty of the conditions of the premises by the landlord might be appropriate.
- Agreement between the landlord and tenant on the appropriate type, method and timing of use of chemicals.
- See also Section I on Environmental Concerns of the Landlord and Tenant.

F. Liability for Rent in Case of Fire or Other Disaster

One question that sometimes arises in rental situations is the responsibility of the tenant to continue paying rent after the destruction of buildings by fire or other disasters. Virginia law specifically provides that if buildings are destroyed without any fault or negligence on the part of the tenant, then he is not bound to continue to pay rent or to re-erect the buildings. [Va. Code Ann., § 55-226.] In fact, he is entitled to a reduction in

the rental for the value of the buildings until such time that they are again available for his use. [Id.] The statute imposes no duty on the landlord to re-build the structures. Lease agreements should provide procedures for this contingency. Additionally, the lease should detail responsibility for insurance coverage and amounts.

Generally, the courts will not require the landlord to repair and maintain fences, building, tiles and similar improvements unless such is required by statute or is in the terms of the lease agreement. If part of the rented property includes buildings, not only the duty and cost of insurance should be include in the rent, both the duty to re-build or not to re-build should be discussed. Absent agreement to the contrary, Virginia law does not require the tenant to pay rent nor does it require either party to re-erect a building if the destruction is so server the premises cannot be used for purposes it was rented or the cost of restoring is greater than one half

the value prior to destruction and the tenant was not negligent. The tenant has an insurable interest and will be liable for loss of landlord's building and rent do to tenant's negligence. For example, short in tenants heat lamp that burns the barn down would create liability for the tenant. [Va. Code §55.226]

The following two sets of clauses may assist the landlord and tenant in their discussion of appropriate agreements for repairs and maintenance of premises.

- Clause A - "The Landlord agrees to replace or repair as promptly as possible the dwelling or any other buildings regularly used by the tenant that may be destroyed or damaged by flood, fire or other cause beyond the control of the tenant or make rental adjustments in lieu of replacements. The Landlord agrees to furnish all materials needed for normal maintenance and repairs of Buildings, fences, etc.

The tenant agrees to provide the labor necessary to maintain the farm and its improvements during his tenancy in as good condition as it was at the beginning,
normal wear and depreciation and damage from causes beyond

the control of the tenant excepted.

The Landlord agrees to reimburse the tenant for the costs of materials purchased for purposes of repair and maintenance in an amount not to exceed \$_____ per year except as otherwise agreed.

The tenant agrees not to buy materials for maintenance and repairs in an amount in excess of \$_____ per year without the written consent of the landlord.”

- Clause B - “The tenant agrees not to erect or permit to be erected on the farm any non-removable structure or building or to incur any expense to the landlord for such purposes.

The landlord agrees to permit the tenant to make minor improvements of a temporary or removable nature, which do not mar the condition or appearance of the farm, at the tenant’s expense and further agrees to permit the tenant to remove such improvements even though they are legally fixtures at any time this lease is in effect or within ___ days thereafter, provided the tenant leaves in good condition that part of the farm from which such improvements are removed.

The tenant shall have no right to compensation for improvements that are not removed except as mutually agreed.” [J.W. Looney, “Farm Leasing Agreements: Repairs, Altercations and Improvements,” National Center for Agricultural Law and Information, Producers Bulletin. No 25, April 1993.

G. The Right of the Tenant in Case of Sale or Condemnation

Virginia law includes provisions to protect the tenant in case the property is sold by the landlord. The law provides that any person who is holding as a lessee will continue to have the same rights on the same terms, after any such sale or any partition between co-owners, as before. (Va. Code Ann., § 55-218.) This statute should be construed in light of the requirement of a written agreement in certain situations because innocent purchasers without notice of the lease or rental agreement may not be bound unless the lease is in writing. The tenants possession and use of the property should serve as notice to the potential purchaser of the existence of a lease. But unless the lease is filed, possession may not be enough to protect the tenant. It is advisable that the tenant and the landlord may want to place a provision in the lease reserving the landlords right to sell

and a provision for a timely cancellation of the lease by the landlord. The right to terminate should come at the end of a crop cycle and before the next crop is planted. The provision could include reimbursement for improvements made, advance preparation, fertilizing and other expenditures a tenant would likely make in preparation of the coming year. Similar provision should be drafted to protect the landlord and tenant from a premature termination due to death of either party and land condemnation. Condemnation of a portion of the unit may reduce the economic feasibility of the lease.

Normally, most standard leases use the terms that the lease is “binding and shall incur to the benefit of the heirs, executive or administrator, successors, and assignors of both the landlord and tenant. Thus the lease without words of termination survives the death of either party. AS this may not be in the best interest of either estate, provisions for

termination, review or removal may be appropriate.

The landlord has the right to mortgage the property and the tenant takes his/her property interest subject to the right of the mortgagor. If foreclosure is necessary, the purchasers at foreclosure is entitled to immediate possession and the lease is terminated at the end of the term. Presumably, the tenant would retain ownership of crops growing on the premises and should be entitled to harvest and remove the current crops.

If the landlord places a mortgage on the property after the lease, then if the lease is properly filed, the mortgage holders interests are subordinate to those of the lessee. The purchaser of the foreclosed property would become the new purchaser under the lease arrangement. Many times, however, the mortgage holder will want the lessee to subordinate these interests. Again, careful drafting resolves tenants and landlords duties and

obligations under the circumstances.

If a lease involves a long term (5 or more years), the tenant may wish to record the written agreement for complete protection against sale by the lessor. Virginia statutes provide for the recording of leases or a memoranda thereof. The recordation tax equals 15 cents on every 100 dollars, or fraction thereof, of the consideration or value, plus a recording fee of one dollar. (Va. Code Ann., § 58.1-807), (Va. Code Ann., § 14.1-112), (Va. Code Ann., § 17-60.) [Update???] However, if the annual rental times the term exceeds or equals the value of the property, then the tax is based on the actual value of the property. This method of recordation suffices for a cash lease where a yearly price is established, but for a flexible or share type lease an equitable value for recording may be difficult to determine. Although recordation entails cost, the protection received by a tenant for

the guaranteed rental length specified, may be well worth the dollars spent.

For a discussion of rights and duties of landlord and tenant if either party enters into bankruptcy, see M. Grossman and T. Fisher, “The Farm Lease in Bankruptcy: A Comprehensive Analysis,” 59 Notre Dame L. Dev. 598(1985) and J. Looney, “Farm Leasing Arrangements:...or Bankruptcy,” National Center for Agricultural Law, Producer Bulletin. No 29, April 1993.

H. Lease Covenants

Much of the language that appears in formally drafted leases derives from history and denotes a well-established meaning in the law.

Sometimes when used in the context of a contract, this language is unclear

to the layman. Virginia statutes attempts to define certain covenants that may appear in leases so that these provisions convey a clear meaning. For example, a covenant "to pay the rent" is by law construed to mean that the rent will be paid to the landlord by the terms of the rental agreement. [Va. Code Ann., § 55-76.] A promise "to pay the taxes" means that all taxes, levies, and assessments on the property will be paid by the tenant. [Id.] A covenant that "he will not assign without leave" promises that during the term of the lease the tenant will not assign transfer, or sublet the premises or any part without the written consent of the landlord. [Va. Code Ann., § 55-77.] The covenant that "he will leave the premises in good repair" promises that at the expiration of the lease term, or earlier if terminated for some other reason, the premises will be surrendered to the landlord in good and substantial repair and condition. [Id.] A covenant by the landlord "for the lessee's quiet enjoyment of his term" means that if the tenant pays the rent, he will enjoy the use of the premises without any disturbance or

interruption on the part of the landlord. [Va. Code Ann., § 55-78.] A covenant that "the lessor may re-enter for default of _____ days in the payment of rent, or for the breach of covenants" ensures that if the rent is unpaid for the number of days specified or if any of the covenants of the contract are breached, then the landlord may re-possess the premises. [Va. Code Ann., § 55-79]. Even under this covenant, the landlord must demand rent due and any damages that have occurred before re-entry or retaking of the premises. [Johnson v. Hargrove, 81 Va. 118 (1885)].

Usually, the lessee may assign a sublet to hold the lease (right to farm the land) in the absents of a statute or covenant in the lease. Covenants that state that the lease "cannot be assigned by tenant without permission of the landlord" mean that. It may be appropriate in a farm lease to modify such language by adding except in the case that the tenant is incapacitated for weeks during planting time or is disable. Whether or to whom the

tenant may assign the lease should be discussed and resolved.

I. Environmental Concerns

In light of recent legal developments and case law, environmental concerns probably constitute the number one legal concern for lessors and lessees. Accidental contamination or spills easily result in damages measured in the millions of dollars and quickly bankrupt the farm operation. Today, no lease agreement is considered comprehensive unless it undertakes a specific allocation of environmental responsibilities. A simple "compliance with all existing laws" clause cannot adequately address issues of environmental liability. ["Coping With Environmental Liabilities in Commercial Lease Transactions," Real Estate Law Journal, Vol. 20, p. 211, 1992. Robert M. Ruzzo.]

The vast majority of environmental liability will be joint and several as between the landlord and the tenant. This means that if a problem occurs, the EPA, other regulatory agency, or damaged party may recover damages from the tenant or the landlord or both. THIS IS REGARDLESS OF WHO IS AT FAULT! The law in this area usually regards the landlord's control or lack of control over the practices of the tenant as irrelevant. Although most of the law has developed in non-agricultural areas concerning hazardous sites, hazardous farm sites are covered by CERCLA (Superfund) and other environmental laws.

Although no surefire solutions to potential environmental liability exist, the following provisions aid in reducing potential liability:

(1)The landlord should obtain an indemnity and hold harmless

agreement from the tenant in the lease. This provision allows the landlord to collect from the tenant if the EPA or other regulatory agency collects damages, fines or penalties from the landlord resulting from the tenant's acts.

(2) However, if the tenant possesses few or no assets, this provision provides little comfort. Moreover, if the problem was created before the tenant took possession of the land, it is not fair to expect the tenant to should a portion of the cost. For the tenant to reduce/ remove liability for prior toxic waste, the tenant should “make all appropriate inquiry” to assure tenants status of an innocent “occupier” of land.

(2) Tenant should promise in the lease to notify the landlord immediately if any spill, contamination or accident occurs, or if the tenant is notified by any regulatory agencies. This will allow the

landlord to take steps to limit liability.

(3) The lease should, as specifically as possible, list what conservation practices the tenant may or should engage in and what practices are disallowed. This list should include any specific environmental concerns, as well as a general promise that the tenant shall obey all federal, state and local environmental laws, rules and regulations. Landlord should be allowed to reenter the premises and oust the tenant and terminate the tenancy if these provisions are violated.

(4) Both the landlord and the tenant should obtain, if available at reasonable cost, insurance against environmental hazards.

(5) Tenant should obtain assurances from landlord as to prior practices on the premises and should receive an indemnity and

harmless from landlord as to landlord's actions. The hold harmless and indemnity clause should survive the termination date of the lease.

(6) Landlord should specify rules concerning subletting or prohibit subletting.

Much of the environmental liability has focused on liability under CERCLA or "superfund". CERCLA was rushed into law during the closing days of the Carter administration. The haste at which it was passed, has created a great deal of uncertainty and litigation. Many scholars have called for a revision of several areas of CERCLA including creating adequate protection for an "innocent " landlord or tenant. But until the statute is revised, CERCLA provides a "beware sign" for farm landlords and tenants. This section will describe the problems, make suggestions about how landlords and tenants can reduce exposure under CERCLA. Toxic sites down on the farm include improper disposal of pesticides, sheep dips from the past, creosoted timber/fence post and some orchard property.

In legalistic terms, CERCLA ¹ (Superfund) imposes *strict liability*² upon *facilities*³ and for *releases*⁴ of *hazardous substances*⁵. Facilities include any building, structure, equipment, ditch, storage container or site a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise become located. The term release includes spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping or disposing in the environment including the abandonment or discarding of closed containers. The term hazardous substance includes any substances or wastes considered hazardous under other federal environmental statutes. Strict liability is imposed with our fault or intent on the part of the parties and is joint and severable. Courts that have addressed the issue have held that landlords and tenants are encompassed with the terms *owners and operators*.⁶ Liability of the

¹CERCLA refers to the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C.A. Secs. 9601-75 (1994) and is commonly known as Superfund.

²New York v. Shore Realty Corp. 759 F.2d 1032,1042 (1985).

³42 U.S.C.A. Sec 9601(9)(1994).

⁴42 U.S.C.A. Sec 9601(22)(1994).

⁵42 U.S. C.A. Sec. 9601(14)(1994).

⁶K. H. Mack, *Environmental Aspects of Landlord/Tenant Relations*, 459 Practicing Law

tenant has been assessed when the tenant generated or stored the hazardous material; exacerbated an already contaminated condition; and sub-leased the property to a tenant who contaminates the property. The landlord has been held liable for the cleanup of the property because of the contractual nature of the relationship, even though the landlord did not agree, to or cause the contamination. Potentially responsible parties (PRP) are liable for the following damages: 1) removal or remedial cost incurred by state or federal government in cleaning the site; 2) any other cost of response incurred by another person consistent with a contingency plan to clean the site; 3) damages to natural resources; and 4) any health assessment plans.⁷

In lay terms, if it is *hazardous* (and most things are hazardous to something, someone at sometime), on the farm and you are an owner or operator, you are liable. The only defense to liability is if you are *innocent*. The definition of innocent is statutory and most owners and operators are by the definition of the law not innocent. There are three basic defenses to strict liability under CERCLA-- an act of God, an act of war and an act or

Institute, Basics of Environmental Law 1993.

⁷42 U.S.C.A. Sec. 9607(a)(1994) and CERCLA Sec. 107(a).

omission of a third party other than an agent or employee of the defendant⁸. The first two are of little value to the landlord and the tenant. The first seldom happens (a flood that deposited contamination on the property); the second we hope never happens; and the third is not likely to happen (Nick Negligence driving his truck with chemicals accidentally on the property and spilling the contents). The third defense also gives rise to what is called the *innocent purchaser defense*. An owner of a property is exempt from CERCLA liability if the owner can establish that the owner was "innocent" at the time the owner took possession of the property.⁹ A landowner is *almost innocent* who did not conduct or permit the generation, transportation, storage, treatment, or disposal of any hazardous substance at the site, who did not *contribute* to a release at the site by *action or omission*, and who did not have any *constructive or actual* knowledge of the hazardous activity. The courts have stringently applied the defense and have held that a lender who foreclosed on the property was not an innocent purchaser because the lender did not conduct an environmental audit prior to the purchase of the property. For a landowner to escape liability, the owner must establish by *due diligence*

⁸42 U.S.C.A. Sec. 9607(b)(1994).

⁹42 U.S.C.A. Sec. 9607(b)(1994).

that the land owner had undertaken all *reasonable and foreseeable steps* to make sure that the property was not contaminated prior to purchase and by implication to the landlord, is not contaminated by the tenant. For a tenant to establish its *innocence* under CERCLA, three requirements must be met: 1) it must have entered into the lease and taken possession after the hazardous substance was placed on the land; 2) it must not have known that the property was contaminated; and 3) it must not have known or had reason to know that the property was contaminated.¹⁰ To meet this requirement, the lessor or lessee must have "undertaken, at the time of acquisition(lease or entering into the lease), all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability"¹¹

What is the appropriate standard of inquiry down on the farm? What is consistent with good commercial or customary practices? We have no court cases defining this standard yet for farm tenants. Therefore, there are several solutions. First, we know that a lender must exercise due diligence by making inquiry (environmental audit) as to the contamination status of the property. Secondly, the duty of inquiry and inspection that is

¹⁰42 U.S.C.A. Sec. 9622(g)(1)(b)(1994).

¹¹42 U.S.C.A. Sec. 9602(35)(b)(1994).

consistent with good commercial practices may be an onerous burden on the tenant/lessee than the lessor/landlord, particularly if the lease is short term. Environmental audits cost money. Therefore, common sense and compromise are required. The landlord could promise to indemnify the tenant for any cost or damages incurred due to hazardous substances found on the facility that the tenant had no knowledge or culpability. The tenant could make an initial inquiry by asking the landlord about past practices as outlined below. [When CERCLA is revised, Congress should consider removing agricultural tenant liability for hazardous waste placed on the property before the tenant taking possession. A statutory requirement that liability be apportioned according to the amount of damages would be in order. For example, if two tenants place x amounts of a hazardous substance on the property, each could be held liable for the % that they contributed. As of today, tenants and landlords, both must use indemnification clauses and due diligence to avoid paying for someone else's mistake. In at least one case, although the landlord and the tenant were held to be joint and severable liable, the court allocated the clean up cost between the two parties by evaluating equitable factors.¹² But, why risk an adverse outcome or the cost of litigation when

¹²South Florida Water Management Dist. v. Montalvo, Civ. No. 88-8038-civ(S.D. Fla. Feb.

a clause in the lease agreement could resolve the issue?

The law creates four classes of person who are liable under CERCLA.¹³ The four classes are:

- Present owners and operators of the facility.
- Persons who owned or operated the facility at the time of the disposal of the hazardous substance (s).
- Persons who generate or arrange by contract for the disposal or treatment of hazardous substances including facilities that they owned or possessed.
- Persons who transported a hazardous substance to the facilities.

The courts have taken a broad reading of the statute to include all of the past and present persons who fall into this category. CERCLA liability and responsibility to the government cannot be contracted away.

However, CERCLA does not bar landlord and tenants from entering into

14, 1989) See also *BCW Assocs., Ltd. v. Occidental Chem. Corp.*, Civ. No. 86-5947 (E.D. Pa., Sept. 29, 1988).

¹³42 U.S.C.A. Sec 9607(a)(1994).

agreements among themselves as to who will ultimately bear the cost of CERCLA liability.¹⁴ Although much of the litigation has involved non agricultural situations, the law does not provide for any agricultural exemption. The *innocent party* defense is only available to owners and operators who use *due diligence* in acquiring and using the land. Today, no commercial lease agreement is considered comprehensive unless it understates specific allocation of environmental responsibilities.¹⁵ Can agricultural leases afford to be far behind? A simple "compliance with all existing laws" clause may not/cannot adequately address issues of environmental liability, especially, when the parties do not even discuss the issue as part of the bargain creating the lease.

Hazardous substances include toxic material as well. Common problem areas down on the farm include improper disposal of pesticides and other chemicals, chemical containers dumped in the "old" sinkhole, improper creosote disposal, sheep dips that were dug into the ground and

¹⁴42 U.S.C.A. Sec. 9607(e)(1)(1994). See also W.P. Jensen, *Lessor and Lessee Liability Under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA): The Catch-22 of Lease Agreements*, 32 *South Texas Law Review* 422-474 (1991).

¹⁵R.M. Ruzzo, *Coping With Environmental Liabilities in Commercial Lease Transactions*, 20 *Real Estate Law Journal* 211 (1992).

contain hazardous chemicals, creosote dips that were created on farms during the construction of railroads (now abandoned rail sites) when the ties were dipped on site, pesticides such as mercury and lead that are in the abandoned farm house, and the farmer that allowed *fly by night* to deposit barrels on the back forty. These examples are based on real cases. In one case, it cost \$250,000 to clean up the contamination left when creosote barrels were improperly disposed of on the farm after the fence was painted.

Landlords must be concerned about the potential liability for actions of their tenant, tenants about potential liability for contamination of the *prior land owner, the landlord and a prior tenant*. The law says all owners and operators unless they are *innocent*. Farming involves some environmental risk in the transportation, storage, use and disposal of farm chemicals. Therefore, each party to the lease should discuss the allocation of the risk, procedures to undertake in a spill or leakage, and attempt to make the party *innocent* under the law. See the preventive action section for more information on how to establish your self as an innocent land occupier.

Other Environmental Management Laws

Besides Superfund, many other environmental management laws create potential liabilities for landlords and tenants. Under the Clean Water Act¹⁶[hereinafter CWA], three major areas of concern to agricultural landlords and tenant arise. Concentrated animal feedlots(feedlots by size and by closeness to water) may require a permit to operate. The permit itself places requirements on the operator to dispose of the animal waste in a prescribed time, place and manner. The CWA requires a permit for the conversion of wetlands. Thus, a tenant who plows under or bulldozes a wetland could create liability for both the tenant and the landlord. A map of the property with such areas clearly marked and an indemnity clause in the lease would put the burden upon the tenant not to destroy wetlands. Conversions of small wetlands have cost property owners over a \$250,000 in fines and reconstruction costs. A third area related to water that a landlord and tenant may want to discuss is a spill contingency plan. Having a plan in effect about how to respond, when to respond and to whom to respond can avoid cost, liability and embarrassment. Such plans should cover animal waste facilities and

¹⁶Clean Water Act (CWA) 33 U.S.C.A. Sec. 1344 *et seq.*(1994).

chemical spill. (See Russ and Geyer, *Responding to Agricultural Hazardous Waste Spills in Virginia: Legal Guidelines and Reporting Procedures*, Virginia Tech.) If the tenant is planning to use the landlord's underground storage tank, the tenant and landlord should agree on the appropriate testing and monitoring procedures to detect leaks. (This author would avoid such use in all but living on the premises situations. And even then, above ground storage might be a better method of storing fuel. But above ground storage still creates liability for landlord and tenant that should be addressed in the lease agreement.

Land that supports endangered species or is adjoining to waters that support endangered species are other areas of potential environmental risk. A clause to reduce the rent if portions of the land or access to a stream were denied because of action related to the protection of the habitat of an endangered species might be appropriate. Similarly, discussions of land use restrictions related to shorelines, coastal areas and the Chesapeake Bay should be under taken by the landlord and tenant. Compliance with Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) reporting requirements under the applicable current regulations would be another clause to insert into the lease agreement.

Preventive Action

The following actions can assist the prudent landlord and tenant in reducing CERCLA liability by establishing an *innocent party* defense and help to assure compliance with other environmental statutes.

1. The tenant should conduct an environmental audit or inquiry about the premises. This can include access to an audit that may have been done by a lending institution. Many conduct a preliminary environmental audit these days before lending on land. The tenant should ask about past practices of the landlord with a retiring farmer and about the history of past tenants.
2. The tenant may ask the landlord to include statements in the lease about the environmental status of the property at the time of the lease. Not only does this help to establish an innocent operator status of the tenant, it creates a base line for both the landlord and tenant for future purposes.

3. The tenant and landlord should agree upon the use or non use of premises for purposes of storage (short term and long term) of chemicals.

4. The tenant and landlord should agree upon the use of commercial applicators as appropriate. The tenant should agree to comply with all state and federal pesticide record keeping requirements.

5. Agreement on the type and application of chemicals should be undertaken by landlord and tenant.

6. The landlord may want to include a clause in the agreement that allocates responsibility and liability to the tenant or the tenant's custom applicator for any contaminating activities under taken by or on behalf of the tenant. The tenant could include warranty statements regarding application and storage of chemicals.

7. Statements requiring the tenant to inform the landlord of any environmental problems that might occur and asking the tenant to assume responsibility for his/her negligence or failure in complying with

environmental regulations or "good chemical field keeping."

8. Agreements and efforts to minimize activities that might cause contamination might be undertaken. See Russ and Geyer, *Green Leasing: Farm Tenancy in an Environmental Era*, Virginia Tech for a discussion of sustainability and alternative leasing ideas. For example, the agreement might require the tenant to adopt IPM (Integrated Pest Management) techniques including a duty to scouting for insects and applying chemicals at "appropriate" level of infestation.

9. A clause requiring the landlord to repair, remediate or remove all environmentally sensitive appendages to the property if required by law or when it is recommend by appropriate experts should be considered. For example, if there is an underground storage tank on the premise, it is best that the tenant not use it. Its removal and liability for leakage could then be assigned the landlord. The exception might be if the tank is a necessary and integral part of a whole farm arrangement. But for cash leases and where the tenants base of operation is elsewhere, the tenant should stay clear of potential liability.

10. Limitation on the ability of the tenant to use the premises for the sale or transport to other property leased by the tenant might be appropriate.

11. An agreement for and how an environmental audit at the end of the lease would be appropriate. Combined with an entry audit, this could protect both the landlord and the tenant and resolve clean up cost and responsibility in a timely manner.

12. The tenant should agree to remove all fixtures, storage areas and chemical containers brought on to the premises and to dispose of such items in an environmentally appropriate manner.

13. The lease term should be long enough to allow the farmer to phase in systems of natural control. To successfully implement alternative environmental controls, research and reports by farmers indicate that a phase in period is required.

14. Crop diversification and rotation, green manure and appropriately applied animal waste are environmentally sound methods to reduce use of chemicals. Because there are potential production and timing concerns

and needs, the landlord and tenant should carefully discuss the cost and benefits and agree in writing on their goals, understanding of the appropriate methods and implementation of such needs.

15. The landlord and tenant may want to review the following clauses for possible inclusion into the lease. The provisions raise the concepts of not committing waste and adopting appropriate stewardship methods in production.

16. The landlord may want the right to cure a violation caused by the tenant such as a spill that is inadequately cleaned up, to preclude further liability. Such a self help provision should authorize the landlord to take the expenses out as additional rent or a rent surcharge to recover the cost of the additional cleanup work.

17. Since environmental disputes often involve complex technical issues and may involve expensive litigation, a provision for handling the dispute resolution in which mediation or arbitration occurs before experience environmental professional may be appropriate.

18. The landlord may want a clause to have the tenant reimburse the landlord for any fines or cost of testing and monitoring which may result from the tenant's activities. The tenant may want to see a clause allowing for a rent rebate or reduction if services of the land are interrupted to clean up property that was contaminated at the time of the lease or that are caused by the landlord. A clause for indemnification from the landlord for all cost and expenses involving environmental problems not caused by the tenant would also be appropriate. Courts are likely to reject indemnification that force the tenant to accept the premises "as is." The liability should be limited by each party to the "hazardous substance" that they put there.

19. The landlord might want to add a clause requiring periodic certification of the property's use or at least discuss the issue each year and when the lease is renewed. The landlord may want to preclude the disposal and storage of any hazardous or toxic materials on the premises.

Sample environmental clauses.

The following are some sample tenant and landlord protective lease

provisions for allocating risks and cost between the landlord and the tenant. These provisions should not be relied upon as legal advice in a particular transaction. Each transaction presents a differing set of facts. Such provisions may be useful as a general framework to shape the discussion and such "form" provisions must be modified to reflect the facts and presented and the law at the time.

- The tenant agrees to control soil erosion as completely as practicably: keep in good repair all terraces, open ditches, inlets and outlets of tile drains; preserve all established watercourses, streams, or ditches including grassed waterways; and refrain from any operation or practice that will injure such structures. The tenant agrees not to plow permanent pasture or meadowland; cut live tress for sale or personal use of tenant, or pasture new seedling of legumes and grasses in the year they are seeded with our consent of the landlord¹⁷
- Tenants shall suffer no waste or injury in or about the demised

¹⁷J.W. Looney, *Farm Leasing Arrangements: Protection and Use of the Property*, National Center for Agricultural Law Research and Information, Producer Bulletin #24, April 1994, page 3.

premises and shall comply with all federal, state, county and municipal laws, ordinances and regulations applicable to the structure, use and occupancy of the demised premises including without limiting the generality of the foregoing the making of any structural repairs that may be required in order to comply with said laws, ordinances and regulations. In addition, tenant shall effect the correction, prevention and abatement of nuisances, violations or other grievance in, on or connected with the demised premises.

- "Toxic or Hazardous Substances" shall be broadly interpreted to include, but not be limited to any material or substance that is defined or classified under federal, state, or local law as a "toxic pollutant, hazardous waste or hazardous substance" such as section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.A. Sec 9601(14), section 307(a)(1) and section 311 of the Clean Water Act, 33USC Sec.1317 (a)(1) and 1321, section 1004 and section 3001 of the Resources Conservation and Recovery Act, 42 USC Sec. 6903 and 6921, section 112 of the Clean Air Act, 42 USC Sec 7412 , as now or hereafter amended: toxic or hazardous

pursuant to regulations promulgated now or hereafter under the aforementioned laws; or presenting a risk to human health or the environment under other applicable federal, state, or local laws, ordinances, or regulations as now or as may be passed or promulgated in the future.

- Tenant agrees to comply with all and future reporting requirements under the Federal Insecticide, Fungicide and Rodenticide Act, the Clean Water Act and any state reporting laws and regulations pertaining to agricultural production.
- Landlord represents and warrants to Tenant that:

Environmental Representation:

- Landlord represents and warrants to Tenant that:
 - (a) Landlord has the full right, power, and authority to execute this Lease and to lease the Premises as provided in this Lease and to carry out all of its obligations hereunder.
 - (b) Landlord is financially capable of performing and satisfying, or has obtained sufficient financial assurance to satisfy, in full its

obligations pursuant to this Lease.

- (c) Neither Landlord nor, to the best knowledge of Landlord, any of pending, or threatened investigation by any governmental authority under any applicable federal, state, or local law, regulation, or ordinance pertaining to air and water quality, the handling, transportation, storage, treatment, usage, or disposal of Toxic or Hazardous Substances, air emissions, other environmental matters, and all zoning and other land use matters.
- (d) Any handling, transportation, storage, treatment, or use of Toxic or Hazardous Substances that has occurred on the Premises to date has been in compliance with all applicable federal, state, and local laws, regulations, and ordinances.
- (e) No leak, spill, release, discharge, emission, or disposal of Toxic or Hazardous Substances has occurred on the Premises to date and the soil, groundwater, and soil vapor on or under the Premises is free of Toxic or Hazardous Substances as of the date the term of the Lease commences. [K. Liegel, "Negotiating and Drafting Lease Provision to Protect the Tenant Against Environmental Liability, (with forms)," 7th Practical Real Estate Lawyer 63-76, Nov. 1991.]

Environmental Indemnity:

- Landlord agrees to indemnify, defend (with counsel satisfactory to Tenant), and hold Tenant and its officers, employees, contractors, and agents harmless from any claims, judgments, damages, penalties, fines, expenses, liabilities, or losses arising during or after the Lease Term out of or in any way relating to the presence, release, or disposal of Toxic or Hazardous Substances on or from the Premises, or to a breach of the environmental warranties made by Landlord above, unless the Toxic or Hazardous Substances are present solely as a result of the actions, of Tenant, its officers, employees, contractors, or agents. That indemnity shall include, without limitation, costs incurred in connection with:
 - (a) Toxic or Hazardous Substances present or suspected to be present in the soil, groundwater or soil vapor on or under the Premises before Tenant occupies the Premises or the Lease Term commences; or
 - (b) Toxic or Hazardous Substances that migrate, flow, percolate, diffuse, or in any way move onto or under the Premises, during Tenant's occupancy of the Premises after the Lease Term commences; or
 - (c) Toxic or Hazardous Substances present on or under the Premises as a result of any discharge, dumping, or spilling (accidental or

otherwise) onto the Premises during Tenant's occupancy of the Premises or after the Lease Term commences by any person, corporation, partnership, or entity other than Tenant, its officers, employees, contractors, or agents . [ID]

The indemnification provided by this section shall also specifically cover, without limitation, cost incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state, or local governmental agency or political subdivision or other third party because of the presence or suspected presence of Toxic or Hazardous Substances in the soil, groundwater, or soil vapor on or under the Premises, unless the Toxic or Hazardous Substances are present solely as a result of the actions of Tenant, its officers, employees, contractors, or agents. Those costs may include, but are not be limited to, diminution in the value of the Premises, damages for the loss or restriction on use of rentable or usable space or of any amenity of the Premises, sums paid in settlements of claims, attorneys' fees, consultants' fees, and experts' fees.

The foregoing environmental indemnity shall survive the expiration or

termination of this Lease and/or any transfer of all or any portion of the Premises, or of any interest in this Lease. It shall be governed by the laws of the state of _____. Notwithstanding any other provision of this Lease, Landlord shall be personally liable without imitation on recourse, for performance of its obligations under this section. [Id.]

Financial Assurances:

- To ensure the continued availability of sufficient funds to satisfy Landlord’s obligations under this Addendum and as an inducement to Tenant to enter into this Lease and in reliance thereon by Tenant, Landlord shall, in addition to the other insurance provisions of this Lease, at its expense, and on or before the execution of the Lease, at Tenant’s discretion:
 - (a) Maintain Environmental Impairment Liability (“EIL”) insurance with respect to the Premises, with minimum limits of One Million Dollars (\$1,000,000) for property damage from an insured and with deductibles that satisfy the other insurance provisions of the Lease; or
 - (b) Obtain a bond or letter of credit in the amount of One Hundred Thousand Dollars (\$100,000), which bond or letter of credit shall

provide for payment thereunder to be applied toward satisfying Landlord's obligations pursuant to this Addendum if Landlord fails to satisfy such obligations; or

- (c) Deposit funds in the amount of _____ Dollars (\$_____)
- in an interest-bearing escrow account, with an escrow agent satisfactory to Tenant, pursuant to an escrow agreement to be signed by Landlord at the signing of this Lease. It is the parties' intention that the escrowed funds may be used by Tenant if Landlord fails to satisfy its obligation hereunder.

Tenants shall be named as an additional insured on the Comprehensive General Liability ("CGL") policy, if required; and Tenant shall be furnished with a copy of such policy, which shall bear an endorsement that the same shall not be canceled without thirty (30) days' prior written notice to Tenant. If Landlord fails to maintain such insurance, Tenant may do so, and Landlord shall reimburse Tenant for the full insurance expenses incurred. [Id.]

Notification Requirements:

- Landlord shall notify Tenant in writing within thirty (30) days of all spill or release of any Toxic or Hazardous Substances, all failures to comply

with any federal, state, or local law, and with any regulation or ordinance, all inspections of the Premises by any regulatory entity concerning the same, all notices, orders, fines, or communications of any kind from any governmental entity or third party that relate to the presence or suspected presence of any Toxic or Hazardous Substances on the Premises or the migration or suspected migration of any Toxic or Hazardous Substances from other property onto or beneath the Premises or to other property from the Premises, and all responses or interim cleanup action taken by or proposed to be taken by any government entity or private party on the Premises. [Id.]

Inspection Rights

- Tenant, its officers, employees, contractors, or agents, shall have the right, but not the duty, to inspect areas on Landlord's property not within Tenant's control to determine whether Landlord or other tenants are complying with federal, state, and local laws, regulations, and ordinances pertaining to air and water quality, the handling, transportation, storage, treatment, usage, or disposal of Toxic or Hazardous Substances, air emissions, other environmental matters, and all zoning and other land use matters. Tenant shall also have the right

to establish test wells on or near its Premises to monitor whether any chemical levels are increasing on or near its Premises because of the activities of Landlord or adjacent tenants. Tenant shall use its best efforts to minimize interference with Landlord's business or that of adjacent tenants but shall not be liable for any interference caused thereby. [Id.]

Corrective Action

- If any investigation, site monitoring, containment, cleanup, removal, restoration, or other remedial work (the "Remedial Work") of any kind is necessary under any applicable local, state, or federal laws or regulations, or is required by any governmental entity or other third person because of or in connection with the presence or suspected presence of Toxic or Hazardous Substances on or under the Premises, Landlord shall assume responsibility for all such Remedial Work and all cost and expenses of such Remedial Work shall be paid by Landlord, unless the Toxic or Hazardous Substances are present solely as a result of the actions of Tenant. [Id.]

Environmental Default Provision

- Any unreasonable interference with Tenant's operations resulting from the presence of Toxic or Hazardous Substances on , under, in, or adjacent to the Premises or from Remedial Work not caused by Tenant shall be a material default for which Tenant may exercise any remedies set forth in this Lease, including, but not limited to: (a) abating rent, or (b) terminating this Lease. [Id]

Although some of the above is written for a commercial client and for the tenant, with malefaction, they can fulfill the needs of the landlord and the agricultural client.

Environmental summary

In summary, the landlord and tenant should discuss the following areas of concern at a minimum:

Who has the appropriate clean up responsibilities and who should be notified..

Definitions of hazardous and indemnification should be included in

the lease

Tenant activities, storage, use and access to premises should be discussed and limited as appropriate.

Remediation standards should be discussed and determined.

Appropriate information as to past practices, audits and government inspections should be shared.

Compliance with all appropriate laws should be required.

The lease could be surrendered by either party for violation of environmental laws.

Tenant should be knowledgeable about the activities of any cotenant if applicable and have information on prior tenants environmental activities.

Both parties should be aware of the limitations of either's liability and the potential joint and severable strict liability of both parties.

Both parties should not shy away from requiring environmental information about each party and both should discuss philosophy and planned actions in this area.

Sustainable Environmental Leases

The following is a list of thirty provisions that landlords or tenants interested in promoting sustainable agriculture practices might want to consider when drafting the terms of a lease. The listed provisions come from a sample lease supplement for soil and water conservation that was developed by the Land Stewardship project⁴⁷ and Neil D. Hamilton's "adjusting Farm Tenancy Practices to Support Sustainable Agriculture".⁴⁸ These topics can be grouped into the following areas: (1) weed and pest control; (2) tillage practices; (3) soil nutrient management; (4) soil conservation practices; and (5) general steward concerns. These should be selected as needed and agreed upon.

Weed and Pest Control

- The tenant agrees to scout for insect populations and apply chemical controls only after such scouting indicates that pests are present at a level sufficient to cause significant economic loss.
- The tenant agrees to control noxious weeds, using nonchemical means if possible, in a timely fashion prior to action by government weed officials.

- The tenant agrees to use mechanical and nonchemical means of control as the primary methods of controlling weeds on crop ground.
- When possible, the tenant will delay the mowing of roads ditches, field edges, grass waterways, set-aside acres, and other areas of vegetation until after the nesting period for game birds and song-birds passed.
- When methods of chemical control of weeds are employed, the tenant agrees to apply them at rates no exceeding the minimums recommended by the manufacturer or extension official.
- The tenant shall ensure that for all fields on which corn was produced, livestock are grazed on the stalk ground prior to the time for spring field preparation. If the tenant does not own livestock, any rent received from leasing the stalk ground to another shall be divided equally between the tenant and the landlord.

Tillage Practices

- The tenant agrees not to cause a moldboard plow for any fall tillage of spring-planted crops.
- The tenant agrees that if any field work, such as chisel plowing, is done in the fall, at least two thirds of the soil will be left covered with crop

residue.

- The tenant agrees not to plow any permanent pasture, meadow, or forage crops without the permission of the landlord.
- The tenant agrees to employ reduced tillage methods for the production of row crops where feasible.
- The tenant agrees to farm pursuant to a conservation plan developed in cooperation with the landlord and state and federal soil conservation officials.

Management of Soil Nutrients

- The tenant agrees to spread available animal manures on fields, but only when the ground is not frozen. Whenever possible, liquid manure from livestock confinement operations and feedlots will be incorporated into the ground the same day it is spread.
- The tenant shall, in cooperation with local extension authorities, develop a system for growing green manure crops that can be planted in the fall and incorporated into the soil prior to spring planting.
- The tenant shall apply purchased fertilizer only after having taken soil samples and received two analyses of the soil tests. Fertilizers shall be

applied at a rate no greater than the recommended rates and at times recommended.

- The tenant shall not apply nitrogen fertilizer in the fall for spring-planted crops. Prior to the application of nitrogen in the spring the tenant shall employ nitrogen soil testing methods if available.
- The landlord shall, in the division of costs and expenses under the lease, give the tenant credit for the nutrient value of green manure crops as demonstrated by subsequent soil fertility tests.
- The tenant shall not mechanically remove any organic material in the form of crop residues left after harvesting of grain crops without the landlord's specific permission.
- The tenant agrees to adopt and implement a system of crop rotations as developed in cooperation with the landlord.
- The tenant agrees not to harvest any forage crops after September 1 without the express written permission of the landlord.

Soil Conservation Practices

- The tenant agrees to deep all grass waterways, terraces, ditches, and tile outlets in good repair.

- The tenant agrees to participate in the development and implementation of a Soil Conservation Service (SCS) conservation plan for the farm.
- The tenant agrees to comply with any requirements of the Agricultural Stabilization and Conservation Service (ASCS), such as those concerning establishing and conserving crops and controlling weeds on set-aside acres, which are necessary to maintain eligibility to participate in federal production control and price support programs.
- The tenant agrees to maintain any existing vegetative or structural measures designed to control wind and water erosion, including the maintenance of strip crops, field wind breaks, contours, water control structures, and ponds.
- The tenant agrees to employ contour farming practices on any slopes that will experience soil erosion if farmed another way.
- The landlord agrees to pay the cost of any soil conservation practices required to comply with the SCS-approved conservation plan for which government cost-sharing money is not available.

General Stewardship Concerns

- The tenant agrees not to graze any timber or wood lots without the landlord's permission.
- The tenant agrees not to cut any standing timber or to engage in any land improvement work, such as removal of trees or hedges, stream channelization, or draining of wetlands, without the express written permission of the landlord.
- The tenant agrees to farm the property in a good and husbandlike manner and to harvest the crops in a timely fashion.
- The tenant agrees to return the property to the landlord in good condition at the end of the lease period.
- The tenant agrees to employ methods of roadside vegetation management other than chemical control.

Although these considerations provide some protection, potential catastrophic liability still exists. The landlord and tenant are also well advised to investigate or be familiar with the practices of the other. If mutual trust does not exist, the lease should not be finalized.

Finally, if no other warning causes a landlord or tenant to seek legal counsel in drafting a lease, potential environmental liability should provide the impetus. Competent legal counsel in drafting a lease may help prevent the loss of the farm operation.

J. **Special Tax Considerations**

In drafting a lease, both parties must be aware that the lease may have unintended income, social security and estate tax consequences. These areas are subject to legislative changes, rule revision by the IRS and interpretation by the courts. Therefore, this section **is not indented to provide you with current information or the solution to your tax problem. It is intended to alert both the landlord and tenant that they must secure competent tax and legal advice and to alert both the landlord and tenant of potential pit falls in lease negotiations.**

1. Income Taxation

For income tax purposes, cash rent will generally be treated as Schedule E or rental income. Income and rent related expenses are declared on the Schedule E or if appropriate, Form 4835 for farm rental income. Landlords should review the information needed on a Schedule E. The advantage of Schedule E for the landlord is that the rental income is not subject to social security taxation. If a landlord under the age of 70 leases the property on a cash basis and take no role in the management or operation of the farm, the income is considered coming from an investment. For the retired taxpayer under the age of 70, this will mean that there is no reduction in social security benefits and to all taxpayers, this means that the income is not subject to social security taxation (FICA taxes.) For a retired taxpayer over the age of 70, the income under any arrangement will not result in a reduction of Social Security benefits.

However, all tax payers should see the following two sections. Rental income is generally considered passive income for purposes of the 1986 Tax Reform Act that does not allow deductions for passive losses (losses generated by selected types of investments) in excess of passive

income (income generated by the same types of investments). Excessive passive losses from real estate investments for the individual investor are allowed up to \$25,000 per year. From a pragmatic standpoint, if the land is being cash rented and you have losses, you should change tenants immediately.

Overtime and after much litigation, the IRS has taken the position (and had it upheld) that conservation and land maintenance obligations that are part of a Conservation Reserve Program payments (herein after CRP) contract constitute a farming trade or business that makes the CRP payments subject to self-employment income tax for farmers. More recently, the U.S. Tax Court issued a ruling that CRP payments are subject to the self-employment tax even if the landowner is not a farmer. Thus a retired farmer who is not materially participating on the farm may be subject to FICA payments on CRP payment as lessor of his farm land. What about the spouse?

For the tenant, expenses and income will be declared on his Schedule F for partnerships, individuals and limited liability companies and 1020 S or C for corporations. The rent is an ordinary expense and entered under the appropriate line. Other expenses and income are commingled with other expenses and income for tax purposes. However, wise tenants keep farm specific numbers and management information to help determine the profitability of each operation to decide which to continue and which to terminate. Tenant net income is subject to social security

taxation.

2. Special Use--Estate Tax--Material Participation

I.R.C. Sec. 2032A provides that, if certain conditions are met, the executor of an estate may elect to value farm real estate on the basis of the property's use as a farm,¹⁸ rather than its fair market value.

Basic requirements to qualify for the Sec. 2032A election include: (1) the deceased must have been a citizen or resident of the United States, (2) the value of the farm (both personal and real property) must be at least 50% of the estate less expenses and debts, and it must have been used for a qualified use at death by the deceased or a member of the deceased's

¹⁸ I.R.C. Sec. 2031A (e)(4) defines farm to include "stock, dairy, poultry, fruit, fur-bearing animals, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities and orchards and woodlands." Farming purposes is defined in I.R.C. Sec. 2032A(e)(5).

family, (3) 20% or more of the adjusted value of the gross estate must be qualified farm real estate, (4) the real estate must pass to a qualified heir, (5) the real estate must have been owned by and used as a farm for five of the last eight years prior to death by the deceased or a member of his family, and (6) the deceased or member of the family must have “materially participated” in the operations of the farm in five out of the eight years immediately preceding deceased's death, date of disability (lasting till death or date of driving social security benefits and continuing until death.

No single factor is determinative of the presence of material participation, but physical work and participation in management decisions are the principal factors to be considered. As a minimum, the decedent and/or a family member must regularly advise or consult with the other managing party on the operation of the business.

The five year material participation requirement of Sec. 2032A must be satisfied for periods aggregating five or more years during an eight year period ending with the earlier of the decedent's death, disability (unable to materially participate mentally or physically), or receipt of old-age social security benefits, provided that disability or social security benefits continue to death.

Section 2032A allows the executor to elect special use valuation for property that was owned by a "qualified decedent" and passes to a "qualified heir" to reduce the value from its fair market value for non farm or small business use such as a housing development or shopping center. It can be used to reduce such value in the decedent's estate by \$750,000. The land must be used in an active trade or business prior to the decedent's death or retirement and after the decedent's death by a family member.

To qualify for special use, the property must pass to a "qualified heir." A qualified heir is generally a member of the decedent's family who agrees to "materially participate" in the operation of the farm for 10 years

after the decedent's death.¹⁹ Failure to qualify or failure to keep the qualification allows the IRS to recompute the estate tax based on fair market value at date of death and recalculate the amount of estate tax due and owing. A 2032A lien is placed on the property to assure compliance.

By regulation, the material participation test is basically the same as material participation test for social security purposes. Material participation is presumed not to have occurred if FICA(self employment taxes) have not been paid. But payment of the tax is not conclusive. It along with physical work and participation in the financial decisions are important. Employment for over 35 hours a week or to a lesser extent for seasonal activity can also meet the requirement.²⁰

Passive cash rental to a non-family member would not be considered "material participation" in the farm business either by the decedent prior death, retirement or disability or by the qualified heir after death.²¹ The decedent and by implication, the qualified heir must own and equity in the

¹⁸.R.C. 2032A.

²⁰Reg. Sec. 20.2032A-3(e).

²¹Reg. Sec. 20.2032A-3(a) and (b).

farm operation and engage in an active business to qualify.²² The estate tax issue is less important today as Congress has raised the amount of dollars that can pass without estate taxes up to \$5,000,000 per individual. Virginia does not collect estate taxes unless the amount is equal to a federal estate tax credit. For most farmers who plan, the estate tax exemption of 5,000,000 each allows 10,000,000 to pass to the next generation with out estate taxes due. The 5,000,000 each is indexed to inflation.

3. Self-Employment

Generally, most farmers report net farm profit as "self-employment income" on section F for tax purposes. Self-employment income normally would not include rental income from farm real estate. However, if the landlord rents personal property such as a tractor or combine with the

²²Reg. Sec. 20.2032A-3(b)(1).

rented land, the rental of personal property would be reported on Schedule C for a self-employed individual and be subject to self-employment tax. Under some circumstances, the landlord participates in the farm operation. In such circumstances, the landowner may be subject to tax as a self-employed individual. The key in these cases is the "material participation" test applied to the landowner. For example, if Farmer Frank owns Frankland acres and rents the land to Frank, LLC as an owner of the LLC, Farmer Frank's rental of his land to the LLC would make the income from the land subject to self-employment tax.

In those situations where self-employment income is involved, it is subject to tax, and at the same time it generates social security benefits. (If lender is over the age of 62 and with drawing SS benefits.) If Farmer Frank has not earned many SS benefits for retirement, Frank may want to find ways to increase SS benefits. There may be circumstances under which an

owner desires to show material participation in order to qualify for social security benefits later.

In other situations the individual may wish to avoid participation in order not to reduce current social security benefits. Often a direct lease agreement will provide that the decision making in the operation is left to the tenant. However, if the landowner continues to be involved and renders substantial services to the farming operation, his income may be considered as self-employment income and serve to reduce current social security benefits.

Social Security Material Participation

The retired farmer/ landlord who is below the age of 70 will not receive his full social security benefits if: (1) the landlord and tenant's

agreement provides that the landlord shall "materially participate" in the production of, or in managing the production of, agricultural products, and (2) the landlord actually participates as called for in the agreement.. The Social Security Act, [42 U.S.C.A. Sec. 411(a)(1)], provides that the activities of a landlord's agent are not to be considered in determining whether the landlord is a material participant. Sec. 2032A, on the other hand, provides that the material participation by either the deceased or a member of his family qualifies for the exception. Thus, assuming that a family member exists, the simple solution involves having the landlord not materially participate and rent the land to a materially participating family member or hire a family member as farm manager. A retired landlord-farmer may, under certain circumstances, receive full social security and qualify his estate for special use valuation. To qualify for both benefits, the farmer must retire at age 65 or older, materially participate during 5 of the 8 years immediately preceding retirement, and during retirement rent out his farm

on a non-material participation crop-share lease. You are materially participating if you have an arrangement with your tenant for your participation and you meet one of the four tests.

TEST NO. 1: You do any three of the following: (1) advance, pay, or stand good for at least half the direct costs of producing the crop, (2) furnish at least half the tools, equipment, and livestock used in producing the crop, (3) consult with your tenant; and (4) inspect the production activities periodically.

TEST NO. 2: You regularly and frequently make, or play an important part in making, management decisions substantially contributing to or affecting the success of the enterprise.

TEST NO. 3: You work 100 hours or more spread over a period

of 5 weeks or more in activities connected with producing the crop.

TEST NO. 4: You do things which, considering their total effect, show that you are materially and significantly involved in the production of the farm commodities.

These tests are essentially the ones set forth in the Social Security publication, "Farm Rental Income: Does it Count for Social Security Payments?" and Farmers Tax Guide IRS Pub. 225. These tests are general guidelines and the ultimate decision is made on a case by case basis. A carefully drawn agreement which limits or includes the activities of the landowner is a must. But again, notwithstanding the provision of the lease, a landowner who in fact participates will be considered to have received self-employment income.

K. Farm Programs

Participation in farm programs is a management tool that many crop farmers will want to undertake. Wise tenants and landlords discuss participation in farm programs and their impact upon the rental agreements. Because some landlords have attempted to cut the tenant out of farm program payments²³ Program payment benefits by law will not be approved if it is determined that the landlord has not given tenants an opportunity to participate in farm programs.²⁴ Payments will be denied if the number of tenants is altered by the landlord in such a way as to provide the landlord with a greater share of the program benefits unless the tenant leaves the farm voluntarily or some reason other than being force off by the landlord or the cash rent tenant was not living on the farm or the cash rent tenant was making less than 50 percent of tenants income from farming.²⁵ Benefits will be restricted to the landlord if the

²³See N. D. Hamilton, *Legal Aspects of Farm Tenancy in Iowa*, 34 Drake Law Review 267 (1984-85).

²⁴7 C.F.R. Sec. 1413.150(a)(1).

²⁵7 C.F.R. Sec. 1413.150(a)(2)(i)&(ii).

land lord extracts an agreement form the tenant which causes the tenant to pay to the landlord any benefits earned from a program, reduces the size of the tenants unit or increases the amount of rent or decreases the share of crop or proceeds, or changes the rights in any way to deprive the tenant of payments or program benefits.²⁶

The regulations provide:

Division of program payment. Each producer's share of the farm program payment for a crop shall be based on the following:

- (1) The producer's share of the crop or the proceeds thereof, or
- (2) If no crop is produced, the share which the producer would have otherwise received had the crop been produced.

Notwithstanding the foregoing sentence, a different division of payment which is fair and equitable may be approved by the county committee if all of the producers who would otherwise share in the division of payments may also be approved the county committee, with the concurrence of a representative of the State committee, even though all of the producers cannot

²⁶7 C.F.R. Sec 1413,150(3).

agree on the division.²⁷

Specific language should be in the lease regarding the division of program payments. However, that language should take into account the division that would be made if there were no program. The government considers the program payments to be a part of the normal "profits" and "income" from the farm and will divide program payments between the tenant and landlord as they normally would be divided. In short, do not as the landlord expect to reap the program payments on the land in the farm programs and leave the tenant only to farm the rest of the land. And tenant, do not accept any arrangement other than which you would be entitled to if no program existed. A landlord and tenant should discuss the program requirements and responsibility of each to maintain base, plant and maintain cover crops, and qualify for program benefits.

Although it is impossible to predict future farm programs and conservation provision of the programs, recent experiences with the Conservation Reserve Program and the provisions relating to participation

²⁷7 C. F. R. Sec. 1413.109(a).

in farm programs have lead courts to preserve rights for tenants. For example, the 1985 farm bill created a Conservation Reserve Program that allowed producers to take land out of production for 10 years by submitting "bids" and "renting" the land to the government for annual payments while the land was devoted to non agricultural production. Tenant's rights to a portion of the CRP contract continue for the lifetime of the contract. Further, the landlord was not able to remove the tenant who was under contract and take over the operation just to receive all of the payment.

The next question to ask, what if the land is sold. Can the tenants interests be removed by the new landlord? The CRP contract provides that if the land is sold, the new owner may 1) continue the contract, 2) enter into a new CRP contract or 3) terminate the original contract.²⁸ However, if the original contract is terminated, the original participant must "forfeit all rights to future annual rental or cost share payments on the transferred acreage; and . . . refund all or part of the payments plus **interest**, as determined by the CCC (asks) that have been made on the transferred land . . . "²⁹ Thus, it is expensive for the current landlord to

²⁸7 C.F.R. Sec. 704. *et seq.*

²⁹7 C.F.R. Sec. 704.20.

leave the program. One court has held that when the land was sold, the tenants continued to be entitled to receive the agreed upon portion of the CRP payments. The purchaser took the property subject to the tenants rights.³⁰ Another landlord was liable for damages resulting from participation in the CRP program without consulting the tenant.³¹ Courts have held that language regarding the sharing of "profits" and the sharing in production cost to include government payments.³²

In short, if you expect or if it is likely that you will farm government programs--payment, price support, quotas and conservation programs, it is best if the parties include language in the lease agreement related to the respective rights of the parties with regard to such programs. At a minimum, a provision should be included in the lease requiring consultation and mutual decision making about state and federal programs. For example, buffer restriction and payments may reduce the profit of the tenant farmer. Should such state payments only go to the

³⁰Weinerstirch v. Leander, 764 P.2d 663 (Wash. App. 1988)

³¹Fordyce v. Musick, 800 P.2d 1045 (Mont. 1990).

³²J.W. Looney, *Farm Leasing Arrangements: Interrelationship with Federal Farm Programs*, National Center for Agricultural Law Research and Information, Producer Bulletin No. 28, April 1993.

landlord, or should they be shared with the tenant. Modifications in writing should be made as appropriate to assure fairness and understanding between the landlord and tenant when program participation is warranted. Remember, the government is providing the benefit for all participants and not just the landlord. Duties about who is to notify the ASCS office and how to account for conservation expenses and compliance with the program should be detailed with the appropriate party to pay for any negligent program participation. For example, what if the tenant plants an inappropriate crop and the payment is reduced because of the error. Should not the lease require the tenant to make the landlord whole. Address the issue up front and not after the fact.

I. Emblements

The issue of who owns the crop sometimes arises. Absent an agreement to the contrary, the tenant owns the crop. With title to the crop, the tenant can pledge the crop, remove the crop, sell the crop or feed the crop subject only to the landlord's lien for rent. This is true

whether the land is cash rented or farmed on a crop share basis. Should the landlord wish to retain a choice in marketing, storage or other decisions either for a management or material participation reason, the issue should be specifically addressed in the leases. An example of such a provision follows:

The tenant shall consult (or secure approval of)with the landlord regarding time, price, sales agency, and similar matters regarding the purchase and sale of livestock, feed, crops, inputs such as fertilizer, seed and herbicides. (or when ever the transaction exceeds \$_____in value.³³

The doctrine of emblements projects the tenant in certain circumstances for the value of his production. Emblements is a common law term for "away going crops...the right of the tenant to carry away crops" growing after expiration of the lease. Virginia statutes provide that where the lease ends through no fault of the tenant, the tenant is entitled to the crops or emblements growing on the land. Such examples could

³³Modification of J. W. Looney, *Farm Leasing Arrangements: Crop Ownership and the Doctrine of Emblements*, National Center for Agricultural Law Research and Information , Producer Bulletin No. 26, April 1993.

arise from the death in midseason of a landlord that is a life tenant of the land, notice to terminate is not properly given or a wrongful eviction is undertaken by the landlord. The Doctrine of Emblements does not apply to a tenant who enters a lease knowing that the crop will not be harvested prior to the specified termination date of the lease. On the other hand, if the tenancy is one created at will (terminable by the landlord at any time) or one year to year but notice to terminate was received **after the crop** was planted, the doctrine is most likely to apply.³⁴

At the common law and as incorporated into the Virginia law by statute³⁵, emblements only applied to annuals or *fructus industrialis* and not perennial crops such as clover, grasses, and fruit trees. Some courts have allowed tenants to return to harvest grass or clover and other courts have not.³⁶ There is not a court case in Virginia on the subject and therefore, the issue can be avoided by drafting the rights and duties of the tenant. The tenant could be allowed to return or the landlord could reimburse the tenant for the cost of establishing the grass or hay crop.

³⁴Id.

³⁵Va. Code Sec. 55-249 *et seq.*

³⁶Repeat loone y above.

Virginia does provide limited protection for land preparation made prior to planting if the right to the crop is terminated prior to planting. The person who succeeds to the land interest must pay a reasonable compensation for such preparation³⁷. Again, this issue can be resolved by addressing the problem in the lease.

The use of the Doctrine of Emblements often arises when the landlord who is a life tenant dies and when there is a tenancy at will or year to year tenancy. A life tenant has the right to the property for the life of a person, often the landlord them selves. Used in estate planning, Ma may give Pa the life income from Greenacre with a remainder interest to the children. The issue comes up as to the tenants rights when Pa passes away during the crop year. The law says that the current tenant in any of these cases has the right to harvest the crop although the lease technically may end. The issue should be solved with the addition of two clauses in the written lease that provide stability for the landlord and the tenant. The first clause states that the lease is binding on heirs and assigns. The second clause could state that:

³⁷Va. Code Sec. 55-251.

"Should this lease be terminated through no fault of the tenant prior to maturity of any growing crop, the tenant should be permitted to gather the same at maturity. The landlord further agrees that the tenant shall have the right of free ingress and egress for this purpose. The landlord agrees to reimburse the tenant at the termination of the lease for field work done and other land preparation expenses such as fertilizer and for other crop cost incurred for crops not yet planted. Unless otherwise agreed, current custom rates for the operation involved will be used to calculate costs."³⁸

FOR GORDON>>>>>>

Economics of a Lease

The main objective of any rental agreement is for each party to secure

³⁸Repeat Looney above with note that it is modified.

a fair return on investments or contributions in the form of land, labor, equipment, and other items. As technology advances and new practices are followed, leases need to be reevaluated. Poor tenancy situations may bring about increased soil depletion with higher production costs. Factors outside the system itself may contribute to poor economic results from leasing. These factors include land valuations, land speculation, high taxes and unstable farm prices. To what extent these outside forces affect leasing arrangements is hard to determine, but it is undoubtedly substantial.

A. How much rent to pay or charge?

Often the first question asked by a prospective tenant when a farm is up for rent is, "How much should I pay?" A landlord is thinking, on the other end, "How much should I charge?" Questions of this nature can be

avoided if the landlord and tenant take some time and evaluate what they have to offer each other. The landlord should take inventory of his resources. What is the land value when kept in farming? What is the productivity of the land? What is the condition of the buildings and fences? Is there an adequate water supply? How many people are interested in renting the farm? Will the lease provisions preserve the value of the property and avoid environmental and other liability? The tenant on the other hand should determine his attributes. Does the rented farm economically optimize his operation and equipment? Am I prepared to take on the added acreage? What is the projected income compared to outlay? How will the tenant be safeguarded in a bad year? How will new technology affect the lease arrangement? What is the environmental status of the property and what additional risks will be incurred?

These types of questions are a small sampling of what needs to be

analyzed. By doing this type of evaluation both parties should come to an agreement before the question of "How much to pay" is asked. The section in this publication on *crop and share leases* will further help in determining an economically fair lease. Area farm management agents, agricultural agents, and farm lenders are a source of what rents are being paid in a community. They will often assist in working out the economics of a fair lease.

B. Rent or Buy

Leasing in some instances constitutes a step towards farm ownership. Fair and equitable leases are a must to keep the rented land in a productive state. A good lease provides incentives for greater production while maintaining conservation practices on rented crop land as well as pasture.

(Law on the Farm, Harold W. Hanna, Associate Professor of Ag. Econ.,

"Economic and Social Implications," pp. 179-180.)

The choice of whether to buy or rent should be evaluated carefully. Often, cash flow dictates the mix between purchased and rented land in a farmer's land portfolio. However, this may not yield the best long term solution in times of volatile farm prices.

When purchasing land, comparisons must be made between the land's market value and its useful capabilities to you. One guideline in buying land may be to budget the maximum price you can pay and still have an increase in your net worth. Another approach calculates the maximum amount per acre you can borrow and repay, given the annual net revenue per acre. These methods assist in establishing a fair price for land.

Land rental involves risk. The type of lease, whether cash, share, or

flexible, greatly shifts the risk between either the landlord or tenant. A cash lease creates little risk for the landlord while a custom farming type lease would reduce the tenant's risk. Which alternative you choose depends on your risk-bearing ability and desire as a landlord or a tenant.

Is there a place for leasing land or should all land be purchased? Yes, there is a place for leasing land, but tenancy rather than ownership reduces your farm operation's stability. Having a landlord say his farm is no longer for rent can be costly and create inefficiencies if additional purchasers or farm equipment was purchased to farm the rental land. Delaying land purchase, if it is affordable, may affect the amount of risk you wish to accept. You may find yourself refusing to add a valuable piece of land to your operation because, psychologically, you cannot accept the debt. On the other hand, buying too much land too soon creates liquidity problems. This causes farm growth to slow, equipment to be used longer

and may reduce improved agronomic practices. An overextended cash position may prompt resale of some land to regain liquidity. When land is purchased that is not affordable to the operation, the operation forgoes other opportunities that would have yielded a higher rate of return.

Knowledge about prices that determine farm earnings provides one key to the rental decision. Careful budgeting and top management aid perspective. Be aware of the penalties in buying too much land too soon and over-extending cash obligations.

The opportunity cost of leasing versus buying must be carefully considered. The following constitute potential advantages of leasing:

- a. Leasing may simplify record keeping. A lease usually forgoes ownership costs. However, building depreciation and other tax

investment incentives are not available to the lessee.

- b. Rental payments constitute deductible business expenses for income tax purposes. When buildings are involved and annual lease payments exceed depreciation and interest charges, some tax savings occur.
- c. The farm operation may easily separate and distinguish the lease from any other financial transaction and management purposes.
- d. Leasing may provide for progressive steps toward ownership at affordable costs. A beginning farmer may obtain access to resources which might not be available should he/she choose the ownership route.

- e. A lease agreement may optimize total utility of a farm, yet not add to the mortgage obligations of the lessee.

- f. A lessor may utilize leasing as an orderly means of phasing out the business without large tax liabilities. Depending on the tax situation and lease agreement, the lessor may receive a higher return through rental income and tax advantages than may be earned in other investments.

- g. Leasing may free up other capital for other investments.

- h. Leasing may free “profits” for investment in other retirement income vehicles such as Keogh and SEP (Self Employment Plans) plans.

- i. Leasing may be the only economic method of acquiring land in a given area.

The following constitute potential disadvantages of leasing:

- a. Assets maintain a residual value at the end of the lease period.
That value generally remains with the lessor and is lost to the tenant. However, negotiation should address this matter.

- b. Both parties surrender a certain amount of control over the asset. This reduced control entails foregoing potential income and provides a setting for potential conflicting interests or potential disagreements.

- c. In the long run, leasing often entails more cost than capital purchase. The cost of the lessor's capital, plus additions of other parties in providing assets to the farm, make the cost of leasing

higher in some instances.

- d. The lessee forfeits eligibility for many tax advantages available with ownership.
- e. The tenant's losses some management control and flexibility.

C. Rent and Buy

A third alternative may be a lease with an option to purchase or the purchase of land using a land contract. The lease with an option to buy may allow an individual to acquire use of more land without the initial investment cost. The tenant has the opportunity of securing access and physical knowledge of the quality of the land without initial purchase. The tenant may also be able to work the lease into a *land contract* after a period of leasing. A *land contract* after a period of leasing. A *land contract*,

contract for deed or installment sale provide tax benefits to the seller and often provide a less than mortgage rate mortgage to buyer and a better than certificate of deposit rate of interest to sell. Lower down payments and mortgage payments may facilitate the acquisition of capital by a tenant farmer. A lessor who has good experience lending the money for purchase of “well maintained” farms.

D. Major Objectives

Once the parties reach a mutual understanding a written lease should be developed. Basically, a written farm lease entails four major objectives:

- The lease arranges a fair division of the income and expenses between the landlord and tenant over the long run. Expenses include both short term (seed, fertilizer), and long term

(irrigation, tile, line, fence).

- The lease aims at making the farming operation profitable for both landlord and tenant.
- The lease assures, as much as possible, that a good tenant may continue his lease through a period of years.
- The lease provides the landlord assurance that his property will be well cared for. Provisions should detail fertility and conservation practices. Maintenance, repairs, and weed and insect control also constitutes important considerations in most leases.

When negotiating a farm lease consider the four major objectives

while undertaking the following steps:

- a. Examine the entire farm and the tenant's machinery, equipment, and other farm assets, together. This procedure provides thorough knowledge of what each party has to offer, as well as identifying areas that should be mentioned in the lease. During this inspection, each party should carry a pad and list both his resources and the other party's resources. At the same time, each party should note the oral understandings discussed during this visit.

- b. A baseline environmental audit should be conducted and any contamination found should be properly dealt with as agreed to by the landlord and tenant before the execution of the lease. Prompt notification of any environmental incident such as a

pesticide or manure to the other party and to the appropriate state regulatory personnel should be clearly agreed to by the landlord and tenant.

- c. Decide upon the farm plan. This initial plan may outline in great detail or in broad terms, depending on the preference of both parties. A well detailed farm plan decreases the likelihood of future disagreements. The plan should include crop rotations, systematic review and repair of buildings and fences as appropriate.
- d. Select from the landlord's and the tenant's resources those assets needed to carry out the farm plan. Place values or percentages on these contributions. It is not uncommon for each party to own something that will not contribute to the

farm organization. An old silo, broiler house, or outdated equipment provide some possible examples.

- e. Decide on what type of lease to use. (See latter section explaining each lease) [Farm Leasing, A Correspondence Course, Virginia Tech Publication 843, December 1979, Lesson 3--Part 2.]

There are five basic types of farm leases:

- 1) the cash lease

- 2) crop-share lease

- 3) livestock-share lease

- 4) labor-shared lease

5) the flexible-rent lease

6) some combination of the above.

Primarily, the type of lease depends on condition of the farm, local custom, and preferences of the individuals involved. The amount of interest and responsibility each party is willing to assume also determine the type of lease used. (Legal Aspects of Virginia Farm Leases, L. L. Geyer (C)..) Individuals close to retirement or retired will want to consider the income, social security, and estate tax consequences of alternative leases.

- f. Negotiate the final agreement. If the agreement constitutes a cash lease, only the landlord's inputs need to be evaluated and a

price assigned to them. The value of the tenant's inputs are not relevant, except for the tenant to evaluate whether he can pay the landlord's rent. In shared leases, both parties' basic contributions will need to be valued, after which income percentage can be determined.

A. Crop Leasing

Crop leasing agreements generally follow three forms: a crop share rent; a cash agreement; or a flexible cash share payment based on current yields and prices.

1. *Cash Rent*

Cash Rent is a fixed payment for the use of land, buildings, and/or

other facilities. Generally, the payment is for a specified time period, is set prior to the tenant using the asset (land) and has set time for payment. The payment times are bargained for but often are payment at the end of the crop year or ½ in spring (prior to taxes) and ½ in fall (after normal harvest). The owner of the asset is compensated for what he/she expects to earn as interest on the investment, real estate taxes, insurance and when applicable, building maintenance, and depreciation on depreciable assets such as irrigation equipment, and fences and buildings.

In return for payment of set rental rate, the tenant receives all the income, takes all the production and price risk and makes all the management decisions. The landlord takes the risk that the tenant will not pay and that the tenant will do damage to the land, buildings, fences, reduce soil fertility, and so forth. The rent provides stable income for the landlord.

Cash leases do not always promote equity, yet they are the most common today. The tenant bears the given rent even if undue circumstances cause a shortage of income. However, cash rent guarantees the landlord a specified amount of income and relieve him of management responsibility. Further, the landlord commits no money into production costs for an uncertain return. Many tenants prefer a cash rent because it allows more freedom in planning their farm programs. Although the tenant assumes added risk with a cash rent, he also receives increased benefits for his management efforts. However, cash rent may not motivate the tenant and/or landlord to maintain or improve the farm. The tenant assumes the biggest risk with a cash rent agreement because of yield and price uncertainties. Crop insurance and/or hedging guard against weather conditions can reduce most price risk. One may determine a fair cash rent through one of the following methods: (1) A percentage of the market

value of the land, (2) Summation of the landlord's expenses and an added return on investment (5-7%), (3) Cash rent based on one third value of expected yield, differentiating between soil potential, (4) Paying a cash rent determined by a fair crop-share return, and (5) the going rental in the area. Although these methods are stated separately, a combination may be more applicable to your situation. [Farm Lease Guide, Dunaway, Morrow, pp. 57-61.]

Issues that should be covered in a cash lease are covenants to comply with sound environmental and crop management techniques, who is responsible for maintenance of level, who is responsible for maintaining fences, irrigation facilities, buildings if applicable use of building for machinery and crop storage, length of agreement, hunting rights, compliance with and sharing in farm programs, and other landlord and tenant concerns.

Unless restricted in the agreement, all management and operating decisions are made by the tenant. The risk of loans and gain are also in the lease of the tenant.. Some of the advantages and disadvantages to landlords and tenants of a cash agreement are outlined below:

Advantages

- It is simple.
- The owner is free of management and the tenant is free to manage.
- The landlord has a steady and determined income.

Disadvantages

- It is riskier for a tenant as the money is paid up front and before production an income is known.
- The owner does not share in the more profitable years.

- The tenant may exploit the land unless restriction are in the lease.
- The owner may be reluctant to maintain buildings and other facilities.

Several of the advantages and disadvantages can be reduced by lease provisions and an understanding and agreement on the issues a head of time. For example, a flexible lease can provide a base income for land and a “share” in the profitable years. Written agreement on time method and who pays for repairs should be undertaken as part of the lease.

A simple method of determining cash rent or desired land rent is to make calculation using the income capitalization formula of $r = iP$ where r = return, i = interest rate, and P = principal. There are many variation of this formula depending on how you choose to determine r , i , and P . If the landowner knows that the assessed value of the land is 1000 per acre and

the owner could get 5% cash return on the land. Because the land may be appreciating in value, the total return on the land might exceed 5%. But appreciation doesn't pay bills until one sells the land. Using USDA return of 3-5% for farm land and knowing what similar land sells for. Laura Landowner could make the following calculation. Assume next door, 100 acres sold for \$1300 per acre and further away sold for \$1200 per acre and mutual underscore return 8%. Taxes are 10.00 per acre. Laura Landowner could then determine that the minimum of her bargain range would be $[(1200 \times 0.03) + 10] = \46 and $[(1300 \times 0.08) + 10] = \114 a maximum 0 range But if land is rented for \$60 in the neighborhood, Laura can calculate that the return will be around 3.8% and 4.1% $[[1200 \div (60-10)] =$ and $[1300 \div (60-10)] =]$.

Over 60 percent of all owners lease land to others under cash leases.

[Leasing farmland in the United States, op at 11] Older land owners are

more likely to lease under crop-share [35 percent] and younger owners with a cash-lease [75 percent]. Eight-two percent of leases in the southeast cash leases includes Virginia and 10% are share leases.

2. ***Crop Share***

In *crop-share* lease, the landlord and tenant share the income from the asset and the expenses of production. Both receive a specified share of the gross income or a specified quantity of the production and both share bargained for expenses of production. Common share arrangements are 50%-50% or 1/3, 2/3, or 40%, 60% to the landlord and tenant respectively. The two key decisions to the economics and management of risk arrangements are who puts what and how much of the production continues into the arrangement and is the gross split as income or physical quantity.

The landlord in most cases, puts the land, real estate taxes, insurance, and if applicable, time maintenance and depreciation on buildings. In a fifty-fifty split, the landlord often provides one-half of the seed and fertilizer. The tenant supply the equipment, fuel, labor, and other half of seed and fertilizer. In a 1/3, 2/3 arrangement, the tenant may supply all the variable inputs such as seed, fertilizer, fuel, equipment, and labor, and harvesting.

Although a *crop-share* calls for shares in gross equal to shares of total expense, local customs and individuals may vary the amount each side contributes and takes in return.

The advantages to a share rent is there is less risk for the tenant and the landlord receives a return approximate to the productivity of the land.

(Your Farm Lease Contract, Farmers' Bulletin No. 2164, USDA). With a good renter the landlord usually obtains a higher return in the long run with a share rent agreement.

The landlord and tenant must determine whether and how to split costs and returns in a crop-share rent agreement. Consider land value, cost of inputs, and expected yields to determine a satisfactory division. A typical arrangement may be a 50:50 division with the landlord and tenant sharing equally the different resources they possess. A tenant may supply management, labor, machinery, fuel and equipment, while a landlord provides land, facilities, taxes and insurance payments, and general upkeep on the farm. The parties most likely will split the cost of seed and of fertilizer evenly. The allocation of the application cost of fertilizer though, sometimes varies depending on how it is applied and who does it. If the fertilizer is custom-applied, the parties usually share the cost. But if the

tenant applies the fertilizer himself, he absorbs the application cost. On a shorter-term lease agreement, fertilizer carry-over needs should be addressed. Phosphorus and potash may be reimbursed to the tenant for up to 40 percent of the cost paid from the last year, if amounts were low when the farm was first rented. Lime has a four- to five-year life. If a tenant leaves after a year or two, he should be compensated for the remaining value of the lime left in the soil. At harvest time, the tenant usually absorbs the full cost of harvesting. Hauling, drying, and storage costs all involve areas of bargaining between the landlord and tenant. [(Farm Lease Guide, Dunaway, Morrow, pp. 39-44)].

The advantages and disadvantages of a *crop-share* for both tenant and landlord are outlined below.

Advantages

- Production and price risk are shared by landlord and tenant.

- The financial risk and up front out lay of the tenant is reduced.
- The landowner has more control over the management and use of his/her land buildings.
- A knowledgeable landlord may improve income by participating in and making operating decision.
- Material participation for purposes of use-value in estate taxation and social security purposes may be secured by the landlord.

Disadvantages

- Conflict between landlord and tenant over operational decisions, pricing decisions may reduce effectiveness of crop-share arrangement.
- The landowner may receive less income in poor price or production years as compared to cash rent and the tenant must share in the good years.

- Materials participation for social security purposes may result unwanted social security taxes to retired or other wise employed individual.

Decision making problems arise more often in crop-share arrangements and should be agreed upon prior to entering into the arrangement. The obvious area of concern are who puts which assets and expenses into the arrangement and what percent or share of production is returned to the landlord and tenant. Other concerns include: Who the marketing decision? How is the final decision made of what to plant, when to plant, where to plant and more when there is a disagreement between landlord and tenant? What is equitable payment if O, forage, or grain is consumed by tenant livestock? Who pays for maintenance? How much should be charged for rental of house? buildings? A review of Chapter 6 may help the landlord and tenant cover and resolve areas of mutual

concern.

CHART 7

EQUITABLE CROP AGREEMENT ISSUES (ROW AND PASTURE)

1. Basis for rental rates:

_____ Farm productivity

_____ Relative contribution of the two parties

_____ Participation in agricultural programs

_____ Who is responsible for completing ASCS forms and records

2. Kind and amount of rent to be paid:

_____ Cash

_____ Flexible

_____ Share

_____ Expenses to be deducted before division of produce

_____ Products for family use

_____ Privileges of buying at farm prices the landlord's share of

feed crops

3. Specifications on payment of rent:

_____ Time when payment is due _____

_____ Place where payment is due _____

_____ Method of dividing share rent _____

_____ Work to be performed instead of payment of rent

4. Schedule for sliding-scale rentals based on:

_____ Fluctuations in prices

_____ Fluctuations in prices and yield

_____ Variations in production conditions

_____ Changes in property taxes or insurance premiums

_____ Property taxes

5. Rent rebates for production losses beyond tenant's control:

_____ Hail

_____ Freezes

_____ Flood

_____ Drought

_____ Disease damage

_____ Insect damage

6. Care Standards for Production

A. Time and frequency of mowing and/or spraying weeds:

Fields _____

Pasture _____

Fence rows _____

Around buildings _____

Efficient production:

1. Specifications regarding crops:

_____ Acreage of crops on the farm

_____ Location of crops (map helpful here)

_____ Rotation to be followed

_____ Winter cover crops

_____ Variety of seed best suited _____

_____ Insurance on crops

_____ Last date to harvest forage crops before winter

_____ Other

2. Use of crops:

_____ Sale

_____ Feed on farm

_____ Handling of straw, fodder

_____ Pasturing small grain _____ Yes _____ No

3. Actions agreed upon in case of neglect:

_____ Hiring persons

_____ Custom work

_____ Applying chemicals

_____ Who pays?

4. Participation in Government programs:

_____ Who decides?

_____ Crop adjustment

_____ Soil conservation

_____ Modification in farming system

_____ Home wood lot

_____ Wildlife preservation

_____ Cooperation of all parties

_____ Who receives benefits?

3. *Flexible Cash Rent*

Flexible cash rent may increase in popularity in the future. The lease combines advantages of both the cash rent and crop-share lease. The leases are as variable as the drafters of such leases. This type of crop rent shifts the risk from the tenant in low-yield seasons and increases the landlord's return in good years. Rent varies in direct relation to the price and yield of a particular year. Quality land is rewarded. In plentiful years, both landlord and tenant share an added premium. In bad years, both

absorb the loss. Advantages of a flexible cash rent include the following points:

- Price and yield determine the rental payment each year, negating the necessity of negotiating a cash rent each year.
- The landlord benefits from the higher yields and higher prices. This benefit encourages him to improve the land and buildings.
- The arrangement strengthens the parties' relationship since most rent is not determined at the beginning of each year.
- The arrangement increases the awareness of both the landlord and tenant towards the best economic opportunity of their product, whether feeding, selling or storing it.

- Flexible leases appeal to absentee owners because they receive added benefits without materially participating.

Several methods of calculating *flexible cash rent* lease follow:

- Fixed rent plus a % of value or quantity over \$X or Y units.
 - Fixed rent minus a % of value or quantity under \$X or Y units.
 - Select a fixed amount of crops and the market price on a certain day to determine the cash payment.
 - Select a lower fixed payment and a lower-crop share percentage and use both to determine the payment.
 - Determine the payment based on a formula involving yields, price, cost indices from USDA and Virginia Agricultural Status.
-
- Two steps - The first step determines a base amount of cash rent for a

landlord in a bad year. This base normally covers taxes, insurance, and a minimum return to the land (Three percent of the land's value usually constitutes a minimum return).

Calculate 20 to 25 percent of an average crop value. This calculation includes the expected price and yield to derive a base price. The second and final step adjusts the base price after harvest to the real rental value of the land. These adjustments narrowly defined, are: (1) additional payment based on price, (2) supplemental rent based on price and yield, (3) rent adjustment based on the value of so many bushels of the actual crop, and (4) a percentage adjustment based on actual yield. To determine the actual yield, the crop should be weighed and moisture tested.

- A flexible rental arrangement can also set a minimum and maximum rent for a given crop.

- A base rent is determined as discussed under crop-leasing.
- A base price and a base yield can be determined by historical prices or by using a five or ten year base price or yield. Adjustments can be made for price or yield variations by one of the following calculations:
 - Price Adjustment. $\text{Current Rent} = (\text{Base rent}) \times \text{Current Price}/\text{Base Price}$.
 - Price and Yield adjustment. $\text{Current Rent} = (\text{Base rent}) \times \text{Current Yield}/\text{Base Yield} \times \text{Current Price}$

The appropriate “current” price in bushels or CWT must be agreed upon by the parties in advance. Many alternatives exist such as a 0 of 0 or XYZ Elevator price or basis points offered “M” month future closing price.

A flexible lease presents many possibilities to ensure fair rent. The

lease agreement should provide the tenant with incentives to produce high yields. Otherwise, the tenant may direct his efforts to other farms rather than the flexibly leased one. Forage crops and buildings do not lend themselves to flexible leases. [Farm Lease Guide, Dunaway, Morrow, pp. 69-78.] But, the resulting lease needs to be written, fair and understood.

- **Practical Leasing**

Suppose that your neighbor is retiring from farming and wants you to farm the crop land. Follow these guidelines in determining equitable rent in this situation. First, pencil out if renting this farm will increase your net farm income or whether you are just "helping out" the neighbor by farming his land. What is the soil productivity of the land? Is the soil "built up" in nutrients? Is the neighbor a reasonable person to work with in deciding a fair rent? Does the landlord prefer a cash, shared, or flexible lease? Cash

rent shifts risk on the tenant. Shared and flexible rent leases constitute more equitable agreements parties but require capital from the landlord. Is the neighbor willing to materially participate? Do you want the neighbor to materially participate? Determine usual land rental for your area.

After sitting down and discussing some of these factors with your neighbor, determine a likely rental. Discuss other factors such as: possible environmental concerns, participation in government programs, conservation concerns, and the length of a probable lease period. Secure a standard lease form from extension services or one third is the back to further develop and cover lease agreement aspects between you and the landlord. Review the check list in this document. One should utilize the standard lease form only for discussion, not to draft a "homemade" lease. Consult your attorney to draft the final lease.

4. *Determining the Cash and Share Rent*

In an equitable, long-term agreement, neither the landlord nor the tenant should wish to be at a disadvantage or to put the other at a disadvantage. That can be avoided by periodically reviewing the lease agreement and by making a determination together of what would be a fair share agreement. Although many landlords and tenants accept the local, traditional shares and rents in their own agreements, this may be a mistake for both sides. The tenant may be making an unwise and uneconomical decision. The landlord may be taking a smaller return on investment than necessary.

An equitable rent or share may be one where owner and tenant shares the gross income in the same proportion as they contribute to the cost of production. [Family Farm Series, Cooperative Extension, University

of California, ANRP 011] To establish the fair shares;

- 1) Determine the contribution made by each party.
- 2) Assign appropriate values to these contributions.
- 3) Calculate the total monetary contributions by the landlord and tenant.
- 4) Establish the share of the total cost contributed by the owner and tenant. [Id.]

TABLE 2: SHARE/RENT DETERMINATION EXAMPLE			
LANDLORD _____		TENANT _____	
Description:			
<u>Expense Cost</u>	<u>Total Cost</u>	<u>Landlord's Share</u>	<u>Tenant's Share</u>
OPERATING COST			
fuel			
repairs			
fertilizer			
lime (Rao Rate)			
insecticide			
seed			
irrigation			
harvest			
interest on capital operating			

lab or (clinic taxes)			
other			
other			
other			
OVERHEAD AND FIXED COST			
real estate taxes			
depreciation			
interest (expected 0)			
Management			
business overhead			
insurance			
other			
other			
Total Costs			
Percent Shares	100%	%	%

Table 2 is an example of using 0 to determine equitable share in a crop-share lease. The operating and fixed cost are allocated to landlord and tenant as appropriate. In working up a work sheet of your own, it is important to list the cost as accurately and fair as possible. Cost such as fertilizer, herbicides and real estate taxes are easy to determine and calculate. Other items will be harder to calculate such as fuel and labor and allocation of management and equipment. Some will involve arbitrary assumption such as land value and appropriate rate of return on land value.

How much of the return is interest and how much should be from increasing land values. U.S.D.A. suggests production units and or surveys might help supply accurate numbers. 0 and 0 Management and Agricultural Agents may have farm record numbers that are realistic. USDA reports a 3-5% returns to agricultural land. Both landlord and tenant should decide appropriate values for these types of contribution. Agreement may not be formal, but it will provide a base for landlord and tenant to bargain for final rent or shares.

Animal Leasing

Animal or livestock leasing may be similar to a crop-share lease or it may involve a simple “rent” of the animals services like a crop-rent agreement. The latter is often used by family members or out-side investors how rent the milk cow to a milking operation for so many cents a

pound of production. Expenses and daily management/milking is undertaken by the lessee and the owner provides the asset and receives a set per unit return, but a vary in return based on total production. The terms of a livestock lease may vary more in content depending on the resource and buildings provide by the landlord. Usually, the landlord supplies the land and facilities, the tenant the labor and equipment and the two parties share the investment in livestock. Operating expenses may or may not be shared.

Advantages and disadvantages are similar to crop-share agreements. Some additional advantages include a new entrant or low equity producer to use the facilities of a returning neighbor and the land and facilities owner to secure a greater return on facilities that are not economically used up but allows the landowner to avoid the labor requirements. This may facilitate a better return for property recently inherited.

Additional problem may arise in the area of disease. Liability for prior infected premises and newly infected premises should be covered by agreement and in severance. With the advent of contract poultry, swine, and feeder cattle feeding operation, livestock share leasing is likely to decline for these commodities.

Animal leasing resembles in many ways a partnership. The landlord shares in the risk by contributing the stock and receives benefit from its generation of income. The landlord's profit potential depends upon the tenant's management techniques and livestock raising ability. Livestock purchases may be a sound investment for non-farm investors because of tax advantages. Animal leasing may be utilized in situation involving retirement, non-farm investors, or a younger person getting started in the business.

Determination of a fair rent for animals depends largely upon the type of stock and the individual situation. A shared lease according to contribution comprises one alternative. Typically a landlord supplies livestock, feed inventories, buildings and handling facilities. A tenant in a share lease provides labor, management, some equipment and may acquire a portion of the livestock as the agreement continues. Both parties share the expenses and both receive income. Wide variations exist in the details of shared-livestock leases and each lease must be tailored to fit the particular situation.

Another alternative involves renting animals on a per-head basis. Sometimes a pasture rental incorporates this type of lease. A cash rental per head may not necessarily be equitable. Nevertheless, both parties may agree to this arrangement. Such provisions must include discussion of the

selection of replacements, death loss, breeding bulls, marketing decisions, feeding practices, and tax considerations. [Business Management for Farms, J. W. Looney, pp. 173-174] The tenant must consider labor efficient equipment and buildings, especially with dairying and feedlot programs. The landlord and tenant must coordinate the number of rented cattle with each party's program to avoid financial strain.

Bargaining plays a large role in establishing a fair lease for both parties. Annual review is a must to keep contributions and returns in balance. [Farm Lease Guide, Dunaway, Morrow, pp. 93-94.]

C. Building Rent

Establishing fair rental for a building involves a more difficult calculations than for land. Computation of income generated by a building

or set of buildings entails difficulty unless the unit is highly specialized.

Perhaps the building's worth determined by the owner exceeds its worth to a tenant. Consider the following guidelines to help determine a rent that is reasonable to both the owner and the tenant:

- a. Building ownership costs, and
- b. the amount that the buildings will contribute to the farm returns.

Annual ownership costs include two parts: fixed and variable costs. Fixed costs continue whether or not the building is used. Depreciation, interest, repairs, taxes, and insurance comprise fixed costs. Depreciation measures deterioration and is calculated most simplest by using the straight line method. For example, the building cost \$40,000 and it's useful

life is 20 years. The annual depreciation charge equals \$2,000 (40,000/20). Check this by IRS numbers. With older buildings, the present value divided by the remaining life years yields the annual depreciation amount. The prevailing market interest rate multiplied by the average investment in a building determines an interest charge. Average investment may easily be calculated as half the original cost of the building. Therefore, in our example, \$20,000 times 10 percent (prevailing rate of interest) equals an interest charge of \$1,800. One may estimate repairs, taxes, and insurance as one percent of the original cost of the building, for each.

The owner's estimated annual costs are summarized in the table below.

Depreciation (20-year life) 20% x\$40,000 =\$2,000

Interest (10% rate)	10%	x20,000	= 2,000
Repairs	1%	x40,000	= 400
Taxes	1%	x40,000	= 400
Insurance	1%	x40,000	= 400

TOTAL			=\$5,200

Although the owner calculates a rent of \$5,200 per year, his annual out of the pocket costs equal \$1,200. So the owner's bargaining range may be from \$5,200 to \$1,200. If the building contains equipment, the equipment rental should be calculated separately using the same procedure. Depreciation and repairs are usually higher on equipment than on buildings. Therefore, a higher percentage should be used. Figures from the building plus equipment ownership cost combine to determine a

feasible building rent.

In valuing older buildings, undepreciated value is probably the easiest to determine. However, one may consider the replacement cost as an alternative to undepreciated value. What would it cost to build a new building comparable to the one you are depreciating? Then depreciate that figure. (This figure also assists in determining the amount of insurance coverage.)

Variable costs include those costs that differ with facility use. Generally, they consist of added repairs that are associated with use. But variable costs may also include electricity and water usage. A short term rental charge should at least cover these direct costs.

Now let's turn the coin over and ask how much can the renter afford

to pay? This determination usually depends on the value of the building to the renter. The renter may require and need a building. Alternatively, the renter's present building may not fully fit his present and expanding needs. Building location constitutes a very important consideration in determining the amount the tenant can afford to pay. Consider the project undertaken and the gross sales from the product. The maximum affordable rent for the building equals the difference between total sales and total costs. Total costs includes a percentage return to management. Partial budgeting greatly assists in determining how a rented facility could benefit a farmer over present conditions.

No accurate method to compute rent on farm buildings exists. Both parties should be careful not to seek the extremes in rent setting. Good bargaining provides the key to either party settling on a rent figure that is fair. [Farm Lease Guide, Dunaway, Morrow, pp. 115-124.]

D. ***Labor-share lease***

A labor-share lease is used by a beginning or law-equity producer. The operation consists of a tenant who supplies labor, management and little or no capital and equipment. The labor-share lease allows the beginning producer to provide management and experience. The tenant encounters more risk than a hired worker, but the expected rewards are greater. Problems arise in determining equitable share, who supplies which management decisions and can the agreement pass the IRS employer-employee test. A labor-share agreement could be a bridge between being a hired worker and moving towards an equal interest in partnership; a limited liability company; or corporation.

VII. Drafting

DRAFT – December, 2013

A. Five Basic Requirements

There are *five basic requirements* for binding written lease:

- 1) an accurate description of the property leased.
- 2) a definite and agreed term over which the lease extends.
- 3) an agreed rental price or term and condition of a crop/livestock share-lease, along with the designation of the time and place at which payment must be made. Example. One half of each years rent is due April 1 and the remainder November 1 of the respective calendar year or tenant will deliver landlord's share of crop to Eastern States Cooperative

with in 5 days of harvest. Tenant will harvest in a timely manner.

4) the names of the lessor (landlord) and the lessee (tenant).

5) the signatures of the parties to the contract.

6) the date the lease is entered into.

In addition to the above clauses, a complete lease should also contain a review time and a date specifying lease termination, should either party choose to do so. In the case of a shared lease, details on when and where crops, livestock or other products are to be delivered to the landlord need to be specified. A minor but important detail, often overlooked, determines the landlord's right to visit, hunt, and inspect the farm. Charts

3, 4, 5, and 6 provide checklists for how to handle disputes [3]; responsibilities for insurance and similar items (4); Conservation and environment needs [5]; and provisions for operating capital [6].

The initial lease should include an arbitration clause. [See Chart 3]

This is always a sensitive area to discuss when two parties are trying to negotiate an agreement with which they can both be happy. No one wants to suggest something might go wrong, but initially, the subject can be discussed rationally.

CHART 2

Minimum Essentials of a Written or Oral Lease

1. Time specifications and designation of parties:

Date of making lease _____

Date lease becomes effective _____ (Date
tenant's occupancy begins)

Date tenant's occupancy ends _____

Lease period

One year

Term of years (specify) _____

Year to year

Provisions for cancellations:

When operative _____

Conditions under which operative _____

Length of notice required _____

Form of notice _____

Address for notice _____

Provisions for termination

Compensation for disturbance? ____ Yes ____ No

Terminates at end of period without notice? _____ Yes _____

No

Date notice of termination or continuance is due

Provisions for renewal:

_____ Continues automatically from year to year unless notice

given

_____ Other type of renewal mutually agreeable

Name and address of landlord _____

Name and address of tenant _____

2. Description of property leased:

Name of farm _____

Farm boundaries or legal description (put description in legal form) (plat or map designation, tax map designation, if possible)

State, county, community

Number of acres in farm

Reservations of any part for landlord? _____ Yes _____ No

(Adequate

description of portion

reserved if yes)

Reservation of heating, water, inspection rights.

Deed book and page reference where the owner obtained title

3. Procedure in case:

_____ Sale of the property

_____ Of death of either party

_____ Either party becomes bankrupt

_____ Tenant becomes incapacitated

_____ Mortgagee takes possession

_____ Hazard to the property or buildings

_____ Eminent domain affecting any portion or all of the property

and buildings

_____ Environmental problems or spill.

4. Signature and acknowledgment:

Signature of landlord

Signature of tenant

Signature of spouse(s), if applicable

Signature of witnesses, if required

Acknowledgment of recording

Notary (optional in most cases unless document is filed in court house.)

B. Checklist of Additional Items to Include in Lease.

In drafting a complete lease, no one identifies all potential problems

initially. A partial checklist to examine when a farm lease is being written follows:

- a. Does the lease encourage the most profitable long-term operation of the farm?

- b. Does the lease encourage the most productive use of capital by both parties involved?

- c. Does the lease encourage the tenant and the landlord to run the farm most efficiently? Who makes the final decision on price, marketing, production under a crop or animal share agreement.

- d. Does the lease encourage farming the land in a good and husbandlike manner? Are their limitations on the use of land

such as tenant must employ XYZ farming practice and maintain all soil conservation projects now in use?

e. Are the returns to the landlord and tenant in equal proportion to their contributions? How are expenses shared, buildings maintained, fences mended, and soil fertility maintained.

f. Are the best available farming methods being used and encouraged by both parties? Is sludge allowed?

g. Is the lease written to maintain soil productivity and make useful long-term improvements? Who pays for liming if needed? Who pays for damages to the land?

h. Does the lease contain provisions to make new and needed

improvements to fences and facilities?

- i. Does the lease contain provisions that clearly detail the practices to be followed and those to be avoided? Who is responsible for which jobs or enterprise? Does the lease require the timely and proper disposal of dead animals?

- j. Who is responsible for insurance and real estate taxes during tenancy? When are accounts settled and rent paid? How is the lease renewed?

- k. Does the lease provide enough details and provide for special problems that may arise? Does the lease spell out record keeping requirements and sharing of relevant records?

- l. Does the lease clearly state how income and expenses will be shared? For example, landlord will pay one-half (1/2) of the chemicals cost and the tenant will pay on-half (1/2).
- m. Does the lease ensure legal protection to both parties involved? Does it create an unwanted partnership? Does it create material participation when wanted or not wanted? Provide termination if one party does not perform. For example: “If either the landlord or tenant fails to perform their duties under contract for a period of thirty days, then the injured party upon written notice, and without cure by the defaulting party, at their option, may terminate the lease.”
- n. Does the lease allow or prevent subleasing? If so, detail the survival of the sublease upon the death of either party.

- o. Does the lease provide for the right of tenant to remove fixtures placed on the property by the tenant? Does the lease include a provision for damages or a required sale of fixtures to landlord when tenancy ends? Most states laws fail to provide for reimbursement of the tenant for unexhausted improvements such as feed troughs, new fences added by tenant.. This contingency should be covered in the lease. If not specified in the written lease, the tenant has no right to recover expenses unless the landlord consents. Alternatively the lease may allow the tenant to take the improvement with them. Also consider the question of whether to reimburse the tenant for the carry-over value of fertilizer and lime when a lease is terminated or reimburse the landlord for a lower value of carryover fertilizer and lime than at time tenancy began..

- p. Does the tenant have the right to use sand and gravel from leased farm? How are water rights allocated? A tenant may usually use sand and gravel located on the premises only for improvements on the farm. When and how the landlord may visit and remain on the property.

- q. Are there provisions addressing contingencies where: the land is sold; fire or other hazards destroy fixtures; eminent domain or other events change the nature of the land use? Are there provisions for lease renewal? Amendments or alterations to the lease?

- r. What right does the tenant have to remove bushes or trees that interfere with crop production? Who's responsibility is to remove crop destroying animals such as a woodchuck.

- s. Are the provisions to assure compliance with local, state, and federal laws and regulations?

- t. Type of buildings and fences on the property, the conditions and structure and fences and the use by the tenant should be reviewed, documented and incorporated into the lease.

- u. If irrigated land is leased, a review of several additional factors should be undertaken. They include the water right of the tenant and the landlord; how much water is available and how will it be used; who is responsible for maintenance/replacement of elements of the irrigation system; what records are required by law and what records should be kept.

- v. Who decides how is the decision made to participate in

government commodity programs, future conservation programs,
and Federal Crop Insurance?

w. Who decides what is to be planted, how much?

x. Who has hunting rights?

y. Who issues what interest and who is responsible for which
accidents? Who is responsible for obnoxious weed control?

z. How is conflict to be resolved? Should provisions be added to
allow for arbitration?

aa. Notarized signature of the parties and their spouses and others
who have an ownership in the property.

The landlord and tenant should consider the following checklist of items before drafting the formal lease. (This check list was originally published in the United States Department of Agriculture Farmer's Bulletin No. 1969 entitled "Better Farm Leases." It has been reprinted in various sources and is modified here.) This list provides a basis for discussion or a working copy of the various aspects of the lease. Not all leases should contain all provisions. However, these matters should be considered by the parties in working out their agreement.

II. STABLE AND SECURE TENURE

1.

2.

5.

IV. EQUITABLE LIVESTOCK AGREEMENT

1. Basis for rental rates

_____ Livestock share agreement

_____ Relative contribution of the parties

_____ Per head basis on pasture

2. Kind and amount of rent to be paid

_____ Cash/per head

_____ Flexible

_____ Share

_____ Products for family use

_____ Feed costs plus yardage (feed figured on dry matter basis)

3. Specifications on payment of rent

_____ Time when payment is due _____

_____ Place where payment is due _____

_____ Method of dividing share rent _____

_____ Work to be performed instead of payment of rent

4. Schedule for sliding-scale rentals based on

_____ Fluctuations in prices

_____ Fluctuations in prices and pounds produced

_____ Based on pounds produced

_____ Property taxes

5. Rent rebates for production losses beyond tenant's control

_____ Unexplained mortality, i.e. birth defect

_____ Other

Efficient livestock production

1. Rules of good husbandry regarding:

_____ General farming operations

_____ Supervision by the landlord _____ Yes _____ No

_____ Period of pasturing livestock _____

_____ Preventative vaccine for disease control

_____ Pasture rotation to follow

_____ Timber and woodlots

2. Specifications regarding time and frequency of mowing or spraying

weeds

_____ Fields _____

_____ Pastures _____

_____ Roads _____

_____ Fence rows _____

_____ Around buildings _____

3. General provisions

_____ Kind and breed of livestock

_____ Use of bulls or artificial insemination

_____ Amount of insurance on livestock ***(ed. note: ?)**

a. fire _____

b. lightning _____

c. flood _____

_____ Responsibility of fence up-keep.

_____ landlord

_____ tenant

_____ Facility maintenance

_____ landlord

_____ tenant

_____ Feed costs, veterinary charges, breed fees, other expenses

_____ Electricity for farm use

4. Special facilities to increase production

_____ Additional and temporary fencing

_____ Additional and temporary buildings

_____ Development of new pastures

_____ Development of new water supply

V. RESPONSIBILITIES OF THE CONTRACTING PARTIES

1. Relating to performance:

_____ Warranty that landlord has right to lease farm

_____ Procedure in event farm is sold

_____ Right of landlord to inspect, improve, and repair

_____ Right of landlord to conduct periodic environmental audits

_____ Agreement regarding subletting of farm

_____ Continuous occupancy throughout the lease period

_____ Agreement regarding off-farm work

_____ Yielding possession at end of lease period

_____ Working for landlord

_____ Assignment of right covered in lease

_____ Environmental considerations

_____ Causes for breach and default (notification of termination

grace period)

2. Relating to joint property:

_____ Appraisals at beginning of lease

_____ Purchases and sales with and without consultation

_____ Keeping farm records

_____ Furnishing vouchers and receipts

_____ Handling joint or undivided funds

3. Relating to settlement at termination of lease:

_____ Provisions for fixtures added by tenant

_____ Appraisal of joint property

_____ Method of dividing joint property

_____ Acreage plowed, seeded, or planted to crops

_____ Value of remaining lime, nutrients applied by tenant

a. At beginning of lease _____

b. Compensation for excess at end of lease _____ Yes _____

No

c. Payment of deficiency at end of lease _____ Yes _____ No

_____ Payment of outstanding debts of joint responsibility

_____ Final environmental audit

4. Insurance

_____ Liability

_____ Hazard

_____ Environmental Hazard/Liability

5. Property taxes

_____ Real property

_____ Personal property/machines and tools

VI. CONSERVATION AND IMPROVEMENTS OF THE FARM

1. Development and maintenance of improvements:

_____ Supplying materials. _____ Landlord _____ Tenant

_____ Furnishing skilled labor. _____ Landlord _____ Tenant

_____ Furnishing unskilled labor. _____ Landlord _____ Tenant

_____ Insurance on buildings. _____ Landlord _____ Tenant

2. Compensation for improvements:

_____ Major improvements

_____ Minor improvements

_____ Soil and land improvements

_____ For superior farming

3. Authorization to remove improvements made by tenant:

_____ Buildings _____ Yes _____ No

_____ Fences _____ Yes _____ No

_____ Fixtures _____ Yes _____ No

4. Environmental compliance

- _____ Allocation of liability
- _____ Indemnity and hold harmless
- _____ Prior regulatory actions
- _____ Notice of subsequent actions
- _____ Insurance

VII. GENERAL PROVISIONS

1. Settling differences:

Arbitration.

Court action.

Payment of legal costs by nonprevailing party?

2. Declarations pertaining to partnership status:

Disavowals.

Admissions.

Qualifications.

3. Items requiring special treatment:

Provisions regarding use and sale of:

_____ Timber

_____ Sand

_____ Gravel

_____ Fish

_____ Game

_____ Minerals

_____ Fill dirt

Specifications on care and maintenance of:

_____ Drains and ditches

_____ Reservoirs and ponds

_____ Terraces and check dams

_____ Bridges

_____ Roads

_____ Buildings

_____ Fences

_____ Gates

_____ Windmills

_____ Motors

_____ Pumps

_____ Orchards and vineyards

_____ Farm wood lot

VIII. OPERATING CAPITAL AND EXPENSES

1. Respective contributions to operating capital:

_____ Machinery and equipment

_____ Special tools and machines

_____ Work stock and power

_____ Productive livestock

2. Respective contributions to labor and operating expenses:

_____ Regular labor _____ Landlord _____ Tenant

_____ Special labor _____ Landlord _____ Tenant

- _____ Machine hire or custom work
- _____ Fertilizer and lime
- _____ Fuel and oil for tractors, trucks, and power equipment
- _____ Electricity for farm use
- _____ Spray and dusting materials
- _____ Spray application method

3. Credit for operating expenses:

- _____ Furnished by landlord
- _____ Furnished by tenant
- _____ Furnished by bank, PCA, FHA, or others

After the landlord and tenant review and discuss these various points, the

pertinent and important details should be spelled out in a document prepared by an attorney. In fact, each party should retain his own attorney to examine the document to ensure that it meets the expectations of all parties. The importance of legal assistance in drafting such a document cannot be overemphasized. This is particularly true in light of the potentially catastrophic liability for each party if environmental hazards arise.

VIII. SAMPLE FARM LEASE AGREEMENT

APPENDIX A SAMPLE LEASE WITH ENVIRONMENTAL CLAUSES

The following example is included to illustrate a typical agreement which includes many of the items mentioned in the check list. This sample lease should not be used by non-attorneys to fashion a "home made" lease.

Please consult with an attorney.

I. Names of Parties and Description of Property.

This lease is entered into this 31st day of December 1995, between ___
Lucinda Landlord ___, landowner, of 500 Main Street, Anytown, Virginia
00000 ___, and Tom Tenant ___,

Address

tenant, of 100 Elm Street, Anytown, Virginia 00000 ___, hereinafter
called the landowner and tenant

Address

respectively. Under the terms and conditions that follow, the landowner hereby leases to the tenant a farm

of approximately 300 acres, situated in Any County, Virginia, and described as follows:

"Landlord Acres" located approximately 5 miles east of Anytown, Virginia on Highway 1000 at the mailing address of Route 1, Box 100, Anytown, Virginia. (A full legal description is attached hereto and incorporated herein)

II. Term of Lease

The term of this lease shall be 3 year(s) from January
, 1 1996
Month Day
to December 31, 1999,
Month Day

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 on or before the 1st day of November, before the expiration of this lease or any renewal thereof. Day Month

III. Rental Rates and arrangements (options not used need not be filled out).

Option A. Crop Share Rent

As rent the tenant agrees to pay shares or quantities of the following crops:

Crop	Approximate No. Acres	Landowner's Share	Tenant's Share	Distribution of Landowner's Share
1. <i>Corn</i>	200	25%	75%	<i>Cash at harvest</i>
2.				
3.				
4.				
5.				

Option B. Livestock Share Rent

Kind	Approximate No. To Be Kept on Farm	Landowner's Share	Tenant's Share	Distribution of Increase

1.	<i>Not Applicable</i>			
2.				
3.				
4.				

Remarks:

Option C. Cash Rent (*Not Applicable Here*)

As rent or partial rent for the farm, the tenant agrees to pay the total sum of _____ dollars (\$ _____) per year. Cash rent will be paid at (place) _____; _____: and as follows: (time) _____.

If rent is not paid when due, the tenant agrees to pay, a late charge of \$_____ per payment, in addition to interest at the rate of _____ percent per annum on the unpaid amount from the due date until paid. [Rent can be differentiated for different crops, etc., or different land uses.]

IV. Farm Operating Expenses

A. The necessary equipment shall be furnished and farm operating expenses divided between the landowner and the tenant as follows:

Machinery and Equipment Expenses	Paid or Furnished by Landowner Tenant		Other operating	Paid or Furnished by Landowner Tenant	
Crop machinery		X	Labor		X
Livestock mach.		N/A			
Mach. repairs		X	Chemicals		X
Fuel		X	Seed		X
Truck		X	Fertilizer		X
Custom work		X	Crop Insurance		X
Real estate tax *	X				
Personal taxes		X	Utilities	X	
Bld. fence reprs	Cost	Labor	Feed	N/A	

Bldg. ins.	X		Misc. Livestock	N/A	
------------	---	--	--------------------	-----	--

Remarks:

[*May want to provide that any increase in real estate taxes over the initial term are to be paid by lessee.]

V. Conservation and Improved Farming Practices.

- A. The landowner and tenant mutually agree to discuss the cropping plan annually and to update provisions stated within the lease.
- B. The tenant agrees 1) to control soil erosion by customary practices used within the community and as agreed by landowner; 2) to use improved practices in the production of crops and livestock as agreeable to landowner; 3) to maintain land and buildings in as good condition as they were when he took possession with reasonable wear and tear, loss by fire, or unavoidable depreciation or destruction excepted; 4) to comply with any and all applicable environmental rules, regulations and provisions of any local, state or federal authority. Failure of the tenant to comply with any of these provisions shall allow landlord to take immediate possession of the premises and exclude tenant from the premises.
- C. Conservation and other practices connected with government programs. Payments which can be earned by participation in the Government Farm Programs shall be handled in the following

manner. Participation in various government programs shall be determined by mutual consent of the parties on an annual basis, on or before January 15 of each year.

Practice and Extent	Contributions		Share of Government Payments	
	Landowner	Tenant	Landowner	Tenant
1. <i>Fertilizer</i>		<i>All</i>		<i>All</i>
2.				
3.				

D. Other improved practices: other improved farming practices which the landowner and tenant agree will be mutually beneficial to both parties.

Practices and Extent

Contributions by Landowner

1. _____
2. _____
3. _____
4. _____

VI. Improvements and Repairs

- A. The landowner agrees to furnish the cost of repairs for maintaining the farm in its customary condition. The tenant will furnish ordinary labor and haul the materials for these repairs. The landowner agrees to pay skilled labor required for maintenance work.
- B. Additional major improvements to be provided by the landowner are as follows:

Kind	Date
<i>None</i>	

- C. Construction and removal of fixtures by tenant: the tenant may add improvements at his own expense, but with the written consent of the landowner only. The tenant shall have the right to remove such improvements at any time prior to termination of the lease, even though they are legally fixtures. He shall have no right to compensation for improvements that are not removed except as mutually agreed.
- D. Compensation to tenant for unused value of improvements: at

termination of this lease, the tenant shall be entitled to payment for the unused value of his contribution to the cost of improvements made with the landowner's consent according to the following schedule:

Proportion (%) Remaining After					
Improvement	1 year	2 years	3 years	4 years	5 years
Lime	80%	60%	40%	20%	0%
Rock Phosphate	80%	60%	40%	20%	0%

VII. Records

Records on all matters of joint interest shall be kept by the tenant and shall be available to the landowner upon request.

The records shall include the following items:

A. All Product Sales C.

B. Any actions or notices received pursuant D.

to environmental rules, regulations
or provisions

VIII. Non-Partnership Agreement

This lease does not give rise to a partnership. Neither party shall have the authority to bind the other without his written consent. Neither party shall be liable for debts or obligations incurred by the other without written consent.

IX. Right of Entry

The landowner shall have the right, in person or by agent, to enter upon the farm for inspections, repairs, or improvements. In case this lease is not to be renewed, after notice of termination by either party, the landowner or the incoming tenant shall have the right to do plowing or other work on the farm if this work does not damage or interfere with the present tenant.

X. Arbitration (optional)

If parties to this lease cannot reach an agreement on any matter, or problem, the question shall be submitted to an Arbitration Committee for decision. This committee shall be composed of three disinterested persons, one selected by each party hereto and the third by the two thus selected. The decision of the Arbitration Committee shall be accepted by both parties.

XI. It Is Mutually Agreed That

- A. This lease shall bind and shall inure to the benefits of the heirs, executors or administrators, of both parties.
- B. The landowner 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.

- C. If the landowner should sell or otherwise transfer title to the farm, he will do so subject to the provisions of this lease.
- D. If the lease is terminated by any means specified in this agreement during the cropping season, the tenant shall be compensated for all expenses incurred toward crop production.
- E. If either party willfully neglects or refuses to carry out any provision, the other party shall have the right, in addition to compensation for damage, to terminate the lease. He shall do so by written notice on the party at fault, specifying the violations of the agreement. If violations are not corrected within 30 days, the lease shall be terminated.

XII. Additional Agreements and Modifications:

Any additions to this contract or change therein shall be in writing and when signed and attached hereto shall become a part thereof.

XIII. In testimony whereof witness our hands at Anytown,
Virginia, on this 31st day
of December, 1995, A. D.

Lucinda Landlord
(Landowner)

Tom Tenant
(Tenant)

Other Lease Provisions to Consider:

1. Environmental Provisions.

A. Environmental Compliance (Tenant's Compliance) (Landlord's View)

Tenant shall, at Tenant's own expense, comply with any existing or hereafter enacted environmental compliance and cleanup responsibility laws affecting Tenant's operation at the premises ("Environmental Laws"). Tenant shall, at Tenant's own expense, make all submissions to, provide all information to, and comply with all requirements of the appropriate governmental authority (the "Authority") under the Environmental Laws. Should the Authority determine that a cleanup plan be prepared and that a cleanup be undertaken because of any spills or discharges of hazardous substances or wastes or any other environmental hazards at the premises which occur during the term of this lease, then Tenant shall, at Tenant's own expense, prepare and submit the required plans and financial assurances and carry out the approved plans. Tenant's obligations under this paragraph shall arise if there is any event or occurrence at the premises which requires compliance with the Environmental Laws. At the expense of Tenant, Tenant shall promptly provide all information requested by Landlord to determine the applicability of the Environmental Laws to the premises, and shall sign any lawful affidavits promptly when requested to do so by Landlord. Tenant shall indemnify, defend and hold harmless Landlord from all fines, suits, procedures, claims and actions of any kind arising out of or in any way connected with any spills or discharges of hazardous substances or wastes or any other environmental hazards at the premises that occur during the term of this lease; and from all fines, suits, procedures, claims and actions of any kind arising out of

Tenant's failure to provide all information, make all submissions and take all steps required by the Authority under the Environmental Laws or any other environmental law. Tenant's obligations and liabilities under this paragraph shall continue so long as Landlord remains responsible for any spills or discharges of hazardous substances or wastes or any other environmental hazard at the premises that occur or are caused during the term of this lease. Tenant's failure to abide by the terms of this paragraph shall be restrainable by injunction.

B. Monitoring Requirements (Landlord's View)

(a) Tenant shall promptly supply Landlord with any notices, correspondence and submissions made by Tenant to appropriate governmental authorities of the State, the United States Environmental Protection Agency ("EPA"), the United States Occupational Safety and Health Administration ("OSHA"), or any other local, state or federal authority that requires submission of any information concerning environmental matters or hazardous wastes or substances.

(b) Conditions Precedent to Assignment and Sublease.

(i) As a condition precedent to Tenant's right to sublease the premises or to assign this lease, Tenant shall, at Tenant's own expense, comply with any hereafter enacted environmental cleanup responsibility laws or other environmental provisions affecting Tenant's operation at the premises (the "Environmental Laws").

(ii) Tenant shall promptly furnish to Landlord true and complete copies of all documents, submissions and correspondence provided by tenant to the appropriate governmental authority ("Authority") and all

documents, reports, directives and correspondence provided by the Authority to Tenant. Tenant shall also promptly furnish to Landlord true and complete copies of all sampling and test results obtained from samples and tests taken at and around the premises.

(iii) As a condition precedent to Tenant's right to sublease the premises or to assign the lease, Tenant shall have received from the Authority either (i) a determination by the Authority that the premises and the proposed sublease or assignment are not subject to the Environmental Laws, or (ii) a determination that the premises satisfies the requirements of the Environmental Laws without the need for any cleanup of hazardous substances or wastes at the premises. If this condition precedent shall not be satisfied, then Landlord shall have the right to withhold consent to sublease or assign the premises.

OR

A. Limitation of Tenant's Environmental Obligations (Tenant's View)

(1) Tenant's Compliance with Environmental Law. Tenant shall, at Tenant's own expense, comply with any hereafter enacted environmental cleanup responsibility laws ("Cleanup Laws") affecting Tenant's use and operation at the premises, if compliance with the Cleanup Laws becomes necessary due to any action or inaction by Tenant. Tenant shall also provide all information within Tenant's control requested by Landlord or any governmental authorities ("the Authority") for preparation of affidavits determining applicability of the Cleanup Laws to the premises should Landlord or the Authority so request, and Tenant shall promptly

execute such affidavits should the information contained therein be found by Tenant to be complete and accurate. If compliance with the Cleanup Laws becomes necessary at the premises due to any action or inaction on the part of Landlord, including but not limited to Landlord's execution of a sale agreement concerning the premises, any change in ownership of the premises, initiation of bankruptcy proceedings, Landlord's financial reorganization or sale of the controlling share of Landlord's assets, then Landlord shall comply with the Cleanup Laws and all requirements of the Authority, at Landlord's own expense.

(2) Landlord's Compliance with Environmental Laws.

(i) Landlord represents and warrants to Tenant that the premises fully comply with federal, state and local environmental laws and regulations.

(ii) Landlord represents that no action has been taken by any federal, state or local authority pertaining to environmental laws or regulations with reference to the subject property within the last five (5) years. Landlord represents that he will provide tenant with copies of all notices or other documentation relating to the subject premises received from any state, local or federal environmental authority received during the time of this lease or received at any time relating to tenant's operations on the property.

(iii) Landlord shall indemnify and defend Tenant from and against any and all liabilities, losses and costs, including Tenant's reasonable counsel fees, that Tenant may incur because of Landlord's breach of the provisions of this paragraph.

B. Allocation of Cleanup Expenditures (Tenant's View).

(a) Costs of Cleanup Compliance. Tenant shall only bear that portion of the costs and responsibilities of compliance with the Cleanup Laws which are applicable to Tenant's discharge, if any, of hazardous substances or wastes at the premises during the lease term and Landlord shall be responsible for paying and undertaking the balance.

(b) Landlord's Indemnification of Tenant. Landlord shall indemnify and defend Tenant from and against any and all liabilities, losses and costs, including Tenant's reasonable counsel fees, which Tenant may incur because of Landlord's breach of the provisions of this paragraph.

2. Attorney's fees

If any party to this agreement incurs costs or attorneys' fees in enforcing any provision of this agreement, the noncomplying party hereby agrees to pay all such costs and reasonable attorneys' fees to enforce this agreement or any provision herein. The noncomplying party further indemnifies and holds harmless the enforcing party against such costs and attorneys' fees.

3. Land Use

A. The land described in Section I will be used in approximately the following manner:

(1) Cropland

- a) row crops _____ acres
- b) small grains _____ acres
- c) legumes _____ acres
- d) rotation pasture _____ acres

(2) Permanent pasture _____ acres

(3) Livestock

_____ acres
_____ acres

(4) Other

_____ acres
_____ acres

(5) Total _____ acres

B. Restrictions

4. Liability, Hazard and Environmental Hazard Insurance

A. Landlord agrees to maintain hazard insurance in the amount of at least \$ _____ on the farm improvements and buildings owned by landlord. Landlord further agrees to replace or repair as promptly as possible any such improvements on buildings that may be destroyed by any cause beyond the control of tenant, or make rental adjustments in lieu of replacements.

B. Tenant agrees to maintain liability insurance in the amount of at least \$ _____ on the premises and shall provide Landlord, by January 15 of each year of the lease term, a certificate of coverage showing landlord and tenant as co-insured. Tenant further agrees to obtain supplementary or coincident coverage in the same amount, to the extent possible, to cover all environmental hazards associated with the business operated on the leased premises. Tenant shall provide a certificate of coverage showing Landlord and Tenant as co-insured with such coverage by January 15 of each year of the lease term.