Leasing Irrigated Farmland

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THE UNIVERSITY *of* TENNESSEE

INSTITUTE *of* AGRICULTURE

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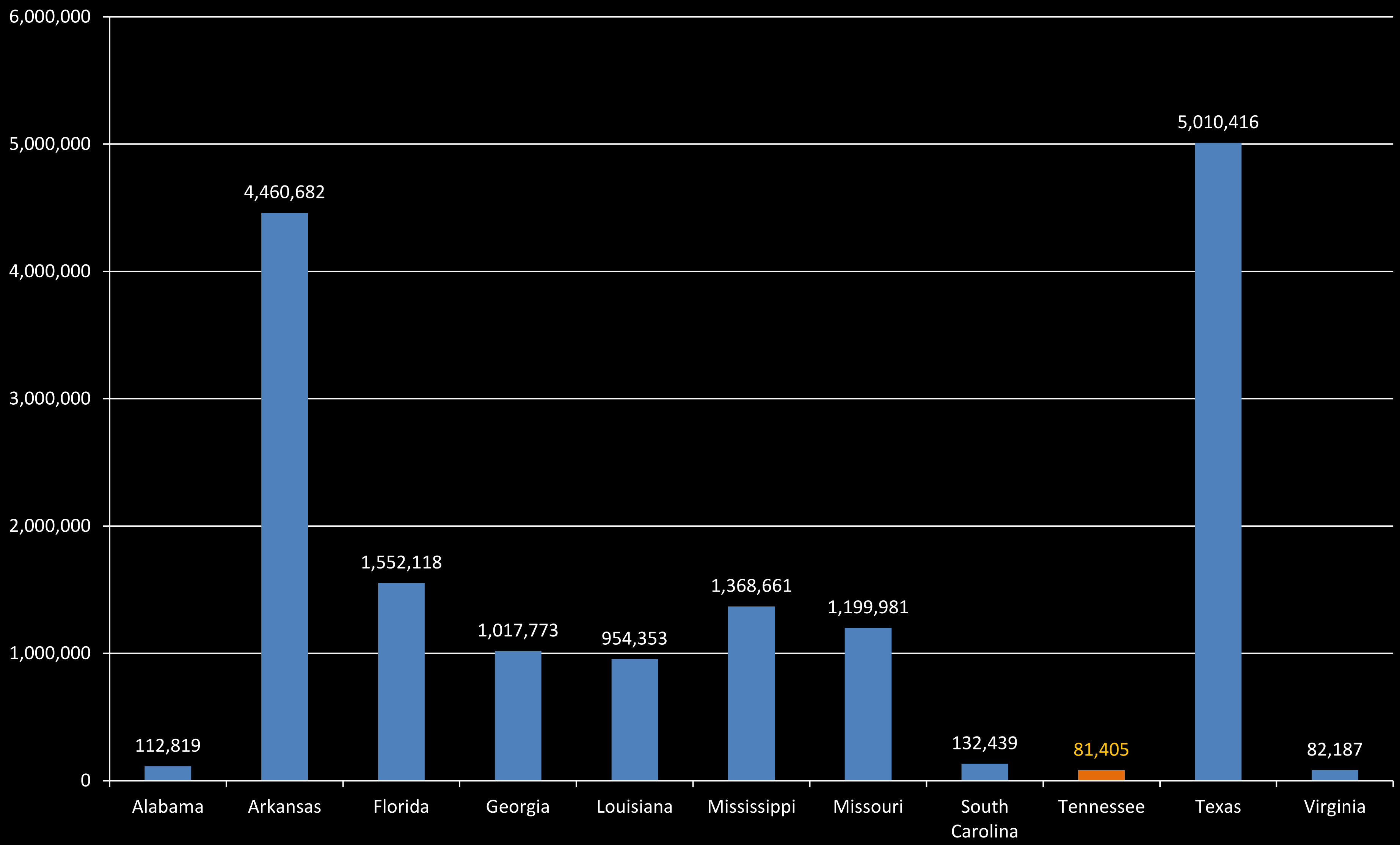
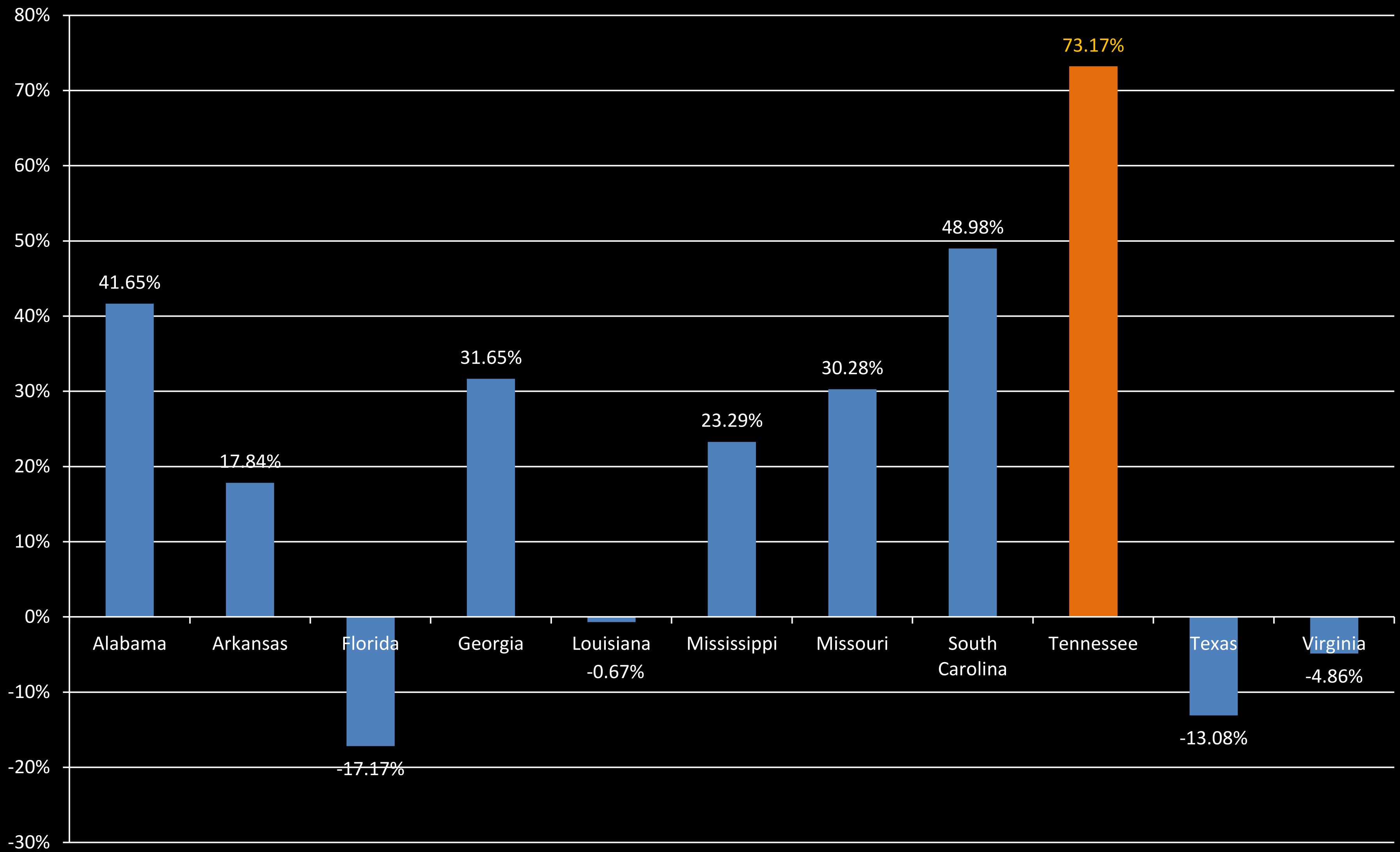
Irrigated Acres by State in 2007



Source: USDA's Farm & Ranch Irrigation Survey

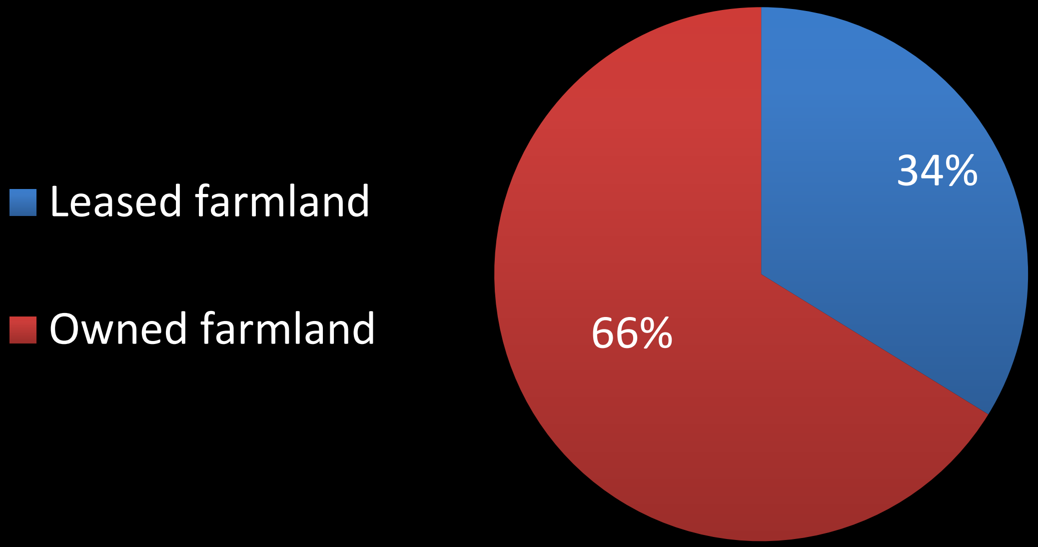
Percentage Change in Irrigated Acres: 1997-2007



Source: USDA's Farm & Ranch Irrigation Survey

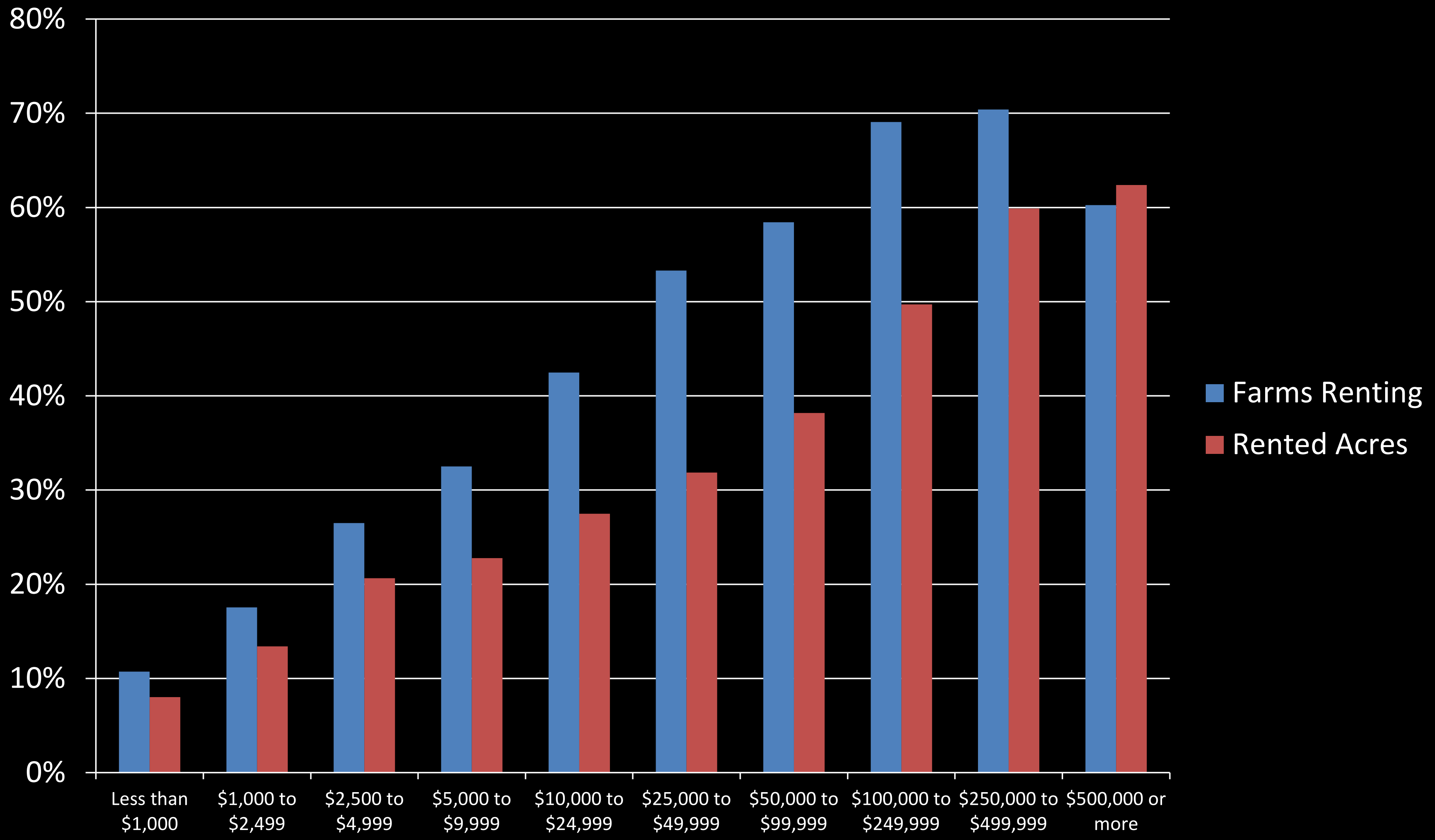
Farmland leasing in Tennessee (2007)

- 27% of Tennessee's farmers lease land from someone else
- 34% of Tennessee farmland is leased



Source: USDA's 2007 Ag Census

Farmland Leasing by Value of Products Sold



Source: USDA's 2007 Ag Census

What is a lease?

- Both a contract and an estate in land (i.e., a property right)
  - By which a landowner transfers to a tenant the right to use and possess real property
    - For a limited period of time
    - Contingent upon payment of rent in the form of cash (*cash lease*) or a share of the crops or livestock produced (*crop* or *livestock share lease*) or some combination of the two (*hybrid lease*)

Types of Farmland Leases

- Cash Leases
  - Fixed
  - Flexible
- Crop or Livestock Share Leases
- Hybrid Leases

Cash Lease

- Fixed cash lease – rent is predetermined or fixed by the lease agreement
  - Tenant makes production and marketing decisions
  - Tenant bears all of production and price risk
- Flexible cash lease – rent is tied to yield, crop or livestock prices, and/or input costs
  - Tenant makes most production and marketing decisions
  - Landowner and tenant share production and/or price risk

Crop or Livestock Share Lease

- Rent is a specified share of the crop or livestock produced
- Landowner and tenant share
  - Expenses associated with operation
  - Production and marketing decisions
  - Production and price risk

Hybrid Leases

- Combination of any of the above
  - Example: Guaranteed bushel lease – rent is a predetermined number of bushels of the crop
- Landowner and Tenant share production and/or price risk

Additional Leasing Resources


UT Extension
PB 1816-A

Introduction to Farmland Leasing

This publication provides management information and guidelines for landlords and tenants to follow when negotiating rental agreements for farmland in Tennessee. It is designed to help landlords and tenants structure a rental arrangement suited to their individual circumstances.

More than a quarter of Tennessee's farmers lease land and leased land accounts for more than one-third of Tennessee's farmland. Thus, continued access to leased land is crucial to the successful operation of many of Tennessee's farms. In addition, leasing provides young farmers with access to land and facilitates the transfer of land from transitioning and retiring farmers. In many instances, farmland leases are of the handshake variety. As a result, many leases fail to provide for a wide range of contingencies that could and should be addressed. This failure can lead to unnecessary conflict between landlords and tenants either because they fail to consider and agree on how to address these contingencies or because one or the other misunderstands or misremembers how the contingencies are to be addressed.

What Is a Land Lease?

A land lease is a contractual agreement by which a landowner transfers to a tenant the right to use and possess land and/or other real or personal property for a limited period of time. In exchange for these rights, the tenant agrees to pay the landowner rent in the form of either a cash payment, a share of the crops produced, or the income from livestock sold.

Why Lease Farmland?

All farm operations have different needs, different cash flow patterns and different income streams. Land can be an expensive resource requiring a large capital investment. If the capital is not available or is a limiting constraint, leasing can provide access to land for fixed or variable rental payments. Leasing also provides an alternate method for young or beginning farm families who cannot afford a down payment or who do not have the sufficient income to meet the financing payments required for starting a farm while building equity for a future purchase.

Also, many individuals or institutions that own farmland are looking for someone to farm it to provide a return on their investment as well as maintain its productivity. Many of these landowners are former farm operators who have retired and who wish to retain their investment in the land for security, retirement income and/or sentimental reasons.

Types of Farmland Leases

- **Fixed Cash Lease** — Cash leases involve a fixed cash rental payment that is specified in the lease and, for farmland, is typically paid on an annual basis. In a cash lease, the tenant bears all of the price, yield and production risks and rewards.

- **Flexible Cash Lease** — Flexible cash leases involve variable instead of fixed rental payments. A formula for calculating the flexible rental payment is specified in the lease and is typically based on changes in crop or livestock prices, yields, and/or certain production costs such as fertilizer, seed or pesticides. For example, if a flexible cash lease is based on crop prices and crop prices increase during the lease, the amount of rent due also would increase. Similarly, if crop prices were to decrease, the rent also would decrease. In flexible cash leases, landlords and tenants can share price, yield, and/or production risks and rewards, depending on the nature of the rent calculation.

- **Crop-share Lease** — With a crop-share lease, the rent paid is a share of the crop produced. The most common landlord-tenant share agreements in Tennessee are the 1/3:2/3, 1/4:3/4, and 1/2:1/2 share arrangements (where the first fraction represents the landlord's share and the second fraction represents the tenant's share). For example, in a 1/3:2/3 share arrangement, the landowner would be responsible for 1/3 of the production expenses and would receive 1/3 of the crop, while the tenant would be responsible for 2/3 of the production expenses and would receive 2/3 of the crop. The landlord and tenant can decide to market and sell the crop collectively or individually. They also share expenses and income associated with the crop and, thus, price, yield, and production risks and rewards.

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UT Extension Publications

Introduction to Farmland Leasing

Cash Leases

Crop-Share Leases

Pasture Leases

Lease Termination

Farmland Legacy Leasing Toolbox
http://www.farmlandlegacy.org/Tools/

- Online decision aid to help landowners and tenants
  - Choose between types of leases and
  - Calculate “acceptable” rental rates

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Home | Budget | Cash Rent for Tenant | Flexible Cash Rental | Crop Share Arrangement | LandownerCost | Comparison Cash Rental

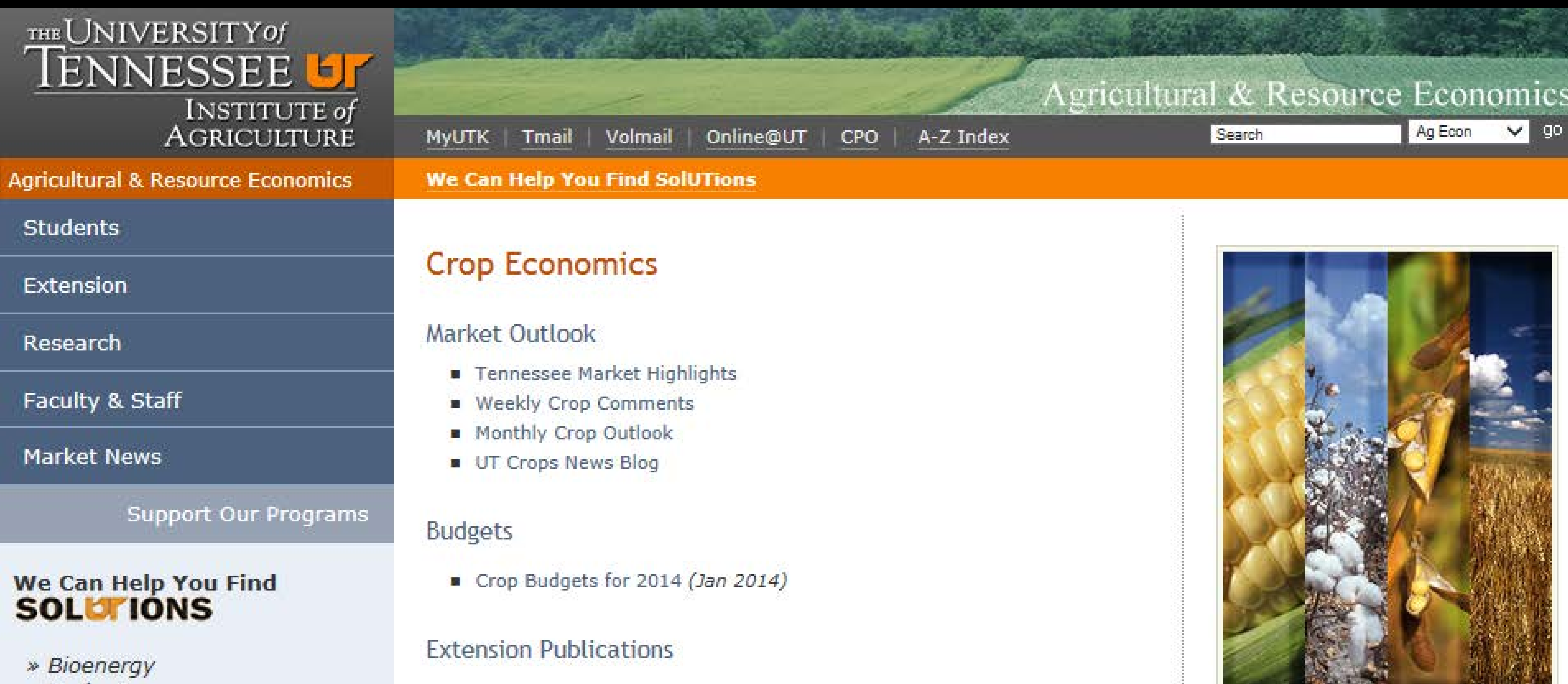
Welcome to the Farmland Legacy Leasing Toolbox

This toolbox contains several calculators to help you estimate equitable rental rates for cash, flexible, and crop-share leasing arrangements.

- **Cash Rent for Tenant Calculator:** One method of establishing a fair, cash rent is based on the tentant's ability to pay. Using this calculator will enable the tentant to estimate the maximum amount he or she can pay as cash rent per acre. The tenant should rent land at something less than this maximum to generate a profit.
- **Landowner Cost Calculator:** One method of establishing a fair, cash rent is based on the landowner’s economic cost of leasing the land. This calculator is one procedure that can be used to help a landowner calculate his or her cost of ownership.
- **Flexible Cash Rent Calculator:** This calculator will help you calculate the cash rental rate in a flexible cash rental agreement based on changes in price and yield.
- **Comparison of Cash Rental Rates:** This calculator will help compare cash rental rates using the prevailing rental rate in the area and the methods discussed in the previous calculators.
- **Crop-share Arrangement Calculator:** This calculator is designed to provide information for establishing a fair and equitable crop share arrangement. The approach used is based on the principle that both parties should share in the total returns in the same proportion as their contributions.

Average Cash Rental Rates by ASD and County (2008 – 2013)

http://economics.ag.utk.edu/crop.html



Irrigation and Farmland Leasing

- How does irrigation influence…
  - Choice of lease type?
  - Rental rate?
  - Lease term?
  - Need for additional provisions?
  - Importance of having a written lease?

Choice of Lease Type

- Landowner and tenant manage yield and price risk by their choice of lease type
- Irrigation…
  - Increases financial commitment
  - Reduces risk of weather-related crop failure
  - Increases expected yield
  - Reduces yield risk but increases price and financial risk
- Changes in risk associated with irrigation may change landowner and tenant preferences regarding lease type

Rental Rate

- Effect of irrigation on rental rate depends on
  - Whether landowner or tenant provides the irrigation equipment and improvements
  - Type of lease (cash or crop share)

Rental Rate

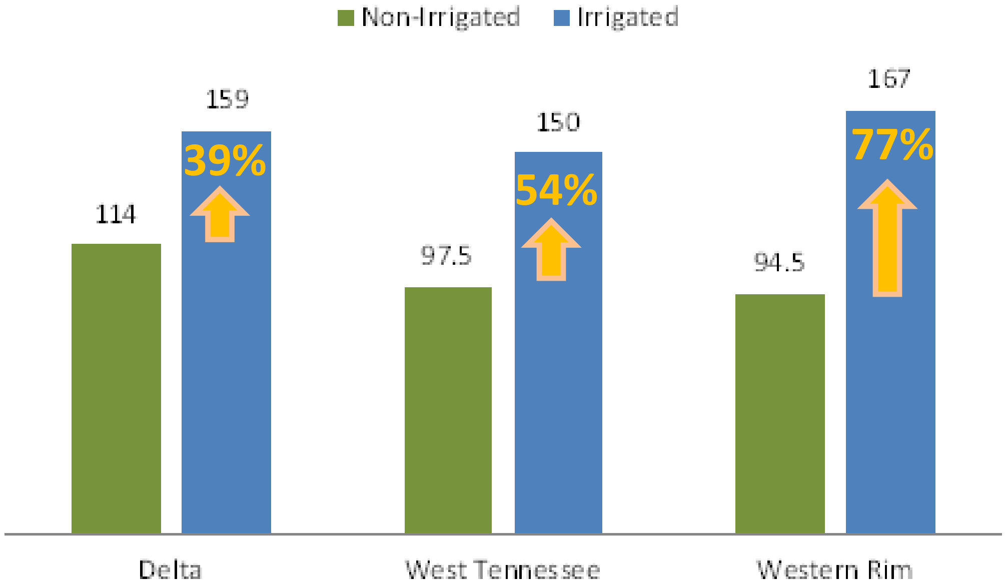
- For a *cash lease* in which *landowner* provides irrigation equipment and improvements
  – Landowner would expect rent to increase by an amount *at least* as much as:
    - The annualized cost of the investment in irrigation equipment and improvements, plus
    - Some positive rate of return on the investment, plus
    - Any variable expenses borne by landowner (e.g., energy/pumping costs)

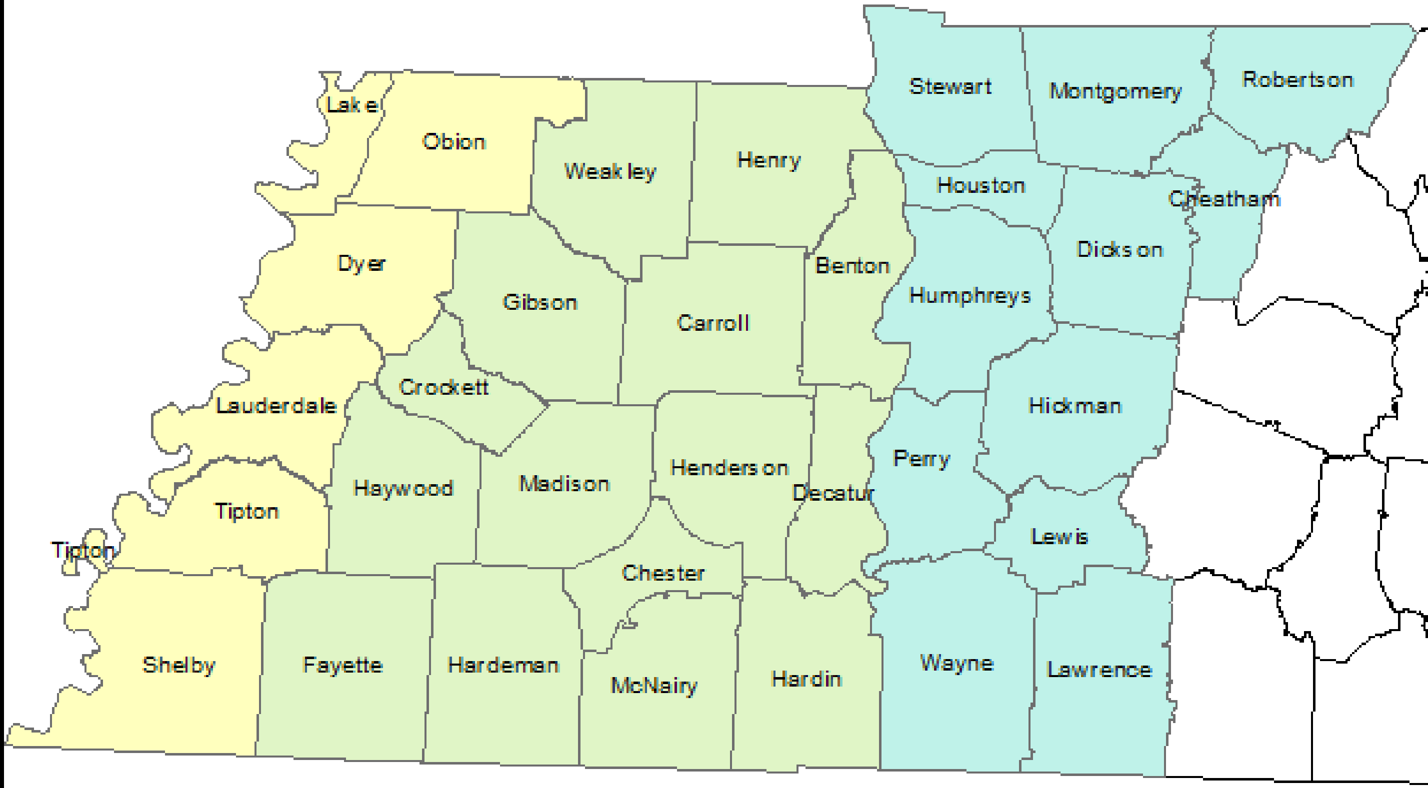
Help for Calculating Annualized Irrigation Costs

Agricultural Extension Service
The University of Tennessee
PB1721

Irrigation Cost Analysis Handbook

2013 Cropland Cash Rental Rates by ASD ($/ac)





Source: USDA

Rental Rate

- For a <u>*cash lease*</u> in which <u>*tenant*</u> provides irrigation equipment and improvements, tenant would likely expect either
  - Rent to *decrease* to the extent that equipment or improvements provided by tenant *increase* value of rented land *beyond the lease term,* <u>or</u>
  - To have right to remove equipment at end of lease term, <u>or</u>
  - To be compensated for the value of any remaining equipment

Rental Rate

- For a *crop share* lease…
  - Landowner and tenant share of total returns should be in the same proportion as their contribution of resources
  - Yield-increasing variable expenses (e.g., energy costs associated with irrigation) should be shared in same percentage as the crop is shared to encourage profit-maximizing behavior

Rental Rate

- Crop share example:
  - Landowner only contributes land which is valued at \$100 per acre non-irrigated, but \$150 irrigated
  - Tenant's annual contributions valued at \$300/ac
  - Should be operating on 1/4 - 3/4 share

$$Landowner: \frac{\$100}{\$100 + \$300} = 25\% \qquad Tenant: \frac{\$300}{\$100 + \$300} = 75\%$$

  - If landowner provides irrigation, landowner's share should increase to 33%

$$Landowner: \frac{\$150}{\$150 + \$300} = 33.3\% \qquad Tenant: \frac{\$300}{\$150 + \$300} = 66.7\%$$

Lease Term

- Party providing irrigation equipment and improvements would typically expect lease term to be long enough to recoup investment
  - Leases for longer than a year have to be in writing to be enforceable

Fixtures

- *Real property* – land and everything that is growing upon or attached to it
- *Personal property* – all other property
- *Fixture* - personal property that is *incorporated into or attached to* real property *so as to become a part of the real property*
  - Becomes real property by virtue of its attachment to real property

Real vs. Personal Property

Land	Physical Alterations to Land	Equipment *"Attached"* to Land	Equipment
Real Property	Real Property	Real Property	Personal Property
		Fixtures	

Why do we care about fixtures?

- Fixtures are owned by the owner of the real property to which they become attached
  - Landowner keeps fixtures upon expiration or termination of a lease regardless of who provided the fixture
  - Tenant may not have an insurable interest in a fixture
  - Landowner’s lender(s) may have security interest in fixtures, while tenant’s lenders may not
  - Taxable as real, not personal property
  - Landowner (not tenant) may be entitled to compensation in the event real property is taken by eminent domain
  - Fixture may pass with sale of real property by landowner (absent contrary provision in sale agreement)

What constitutes a fixture?

- Tennessee courts look at three factors in determining whether something is a fixture
  - Attachment to real property
    - Physical or *constructive* attachment
  - Adaptation to use of real property
    - The more useful an article is to operations conducted on the property, the more likely it is to be considered a fixture
    - The more useful an article is at other locations, the less likely it is to be a fixture
  - **Intent of the parties**
    - Evidence of intent to *permanently* attach
      - For example, whether removal would cause material injury to the real property or other fixtures

Fixture Cases

- Rowan v. Riley (Idaho 2003)
  - In a dispute over land that had been partitioned, well and well casings were held to be fixtures

Fixture Cases

- Schwend v. Schwend (Montana 1999)
  - Plastic irrigation pipe that could be easily attached and unattached to an underground main line via riser pipes and that could be picked up and moved around by 1 person were held not to be a fixture
- Wyoming State Farm Loan Board v. Farm Credit Capital Corp (Wyoming 1988)
  - Plastic pipe only intermittently connected to risers was not a fixture


Fixture?

Fixture Cases

- Rayl v. Shull Enterprises, Inc. (Idaho 1985)
  – Tenant removed center pivot irrigation system at end of lease by digging up underground wires and pipes and unbolting the pivots from cement slabs
  – Court held irrigation system to be a fixture
    - System was annexed to the land because bolted to cement slabs and attached to pipes and electrical wires buried underground
    - System was adapted to the land in that land was used for farming and the system was necessary to farm the land, and the system was adapted to the particular ground being farmed
    - Farmer who installed the pivot system destroyed existing ditch irrigation system, suggesting he intended system to be permanent

Fixture Cases

- Western Ag. Land Partners v. Washington Dept. of Revenue (Washington 1986)
  - Center pivot irrigation system was held to be a fixture which passed with sale of the land
- In re Sand & Sage Farm & Ranch, Inc (Kansas 2001)
  - Court held that center pivot irrigation system was a fixture and, thus, lender with mortgage had valid security interest (as opposed to lender with security interest in debtor's "equipment")
    - Court explicitly considered difficulty and expense of moving the irrigation system ($4,000 -$6,000) relative to the value of the system ($10,000)

Additional Provisions

- Who is responsible for…
  - Insuring the irrigation equipment?
  - Maintaining the irrigation equipment?
  - Paying taxes on the irrigation equipment?
- Restrictions on tenant’s irrigation practices to avoid impact on water supplies?
- What happens at the end of the lease term?
  - Who gets the irrigation equipment?
  - Is compensation owed to the one who provided the equipment?

Additional Provisions

- Compensation for irrigation equipment and improvements at least termination

Compensation for Improvements Table

Type of improvement	Date to be completed	Estimated total cost	Proportion to be contributed by tenant			Total value of tenant's contrib.*	Rate of annual depreciation
			Material	Unskilled labor	Mach.		
Irri. Well		$	%	%	%	$	%
Underground Pipe		$	%	%	%	$	%
Land Dev.		$	%	%	%	$	%
Tailwater Structures		$	%	%	%	$	%
Power Lines		$	%	%	%	$	%
Other		$	%	%	%	$	%

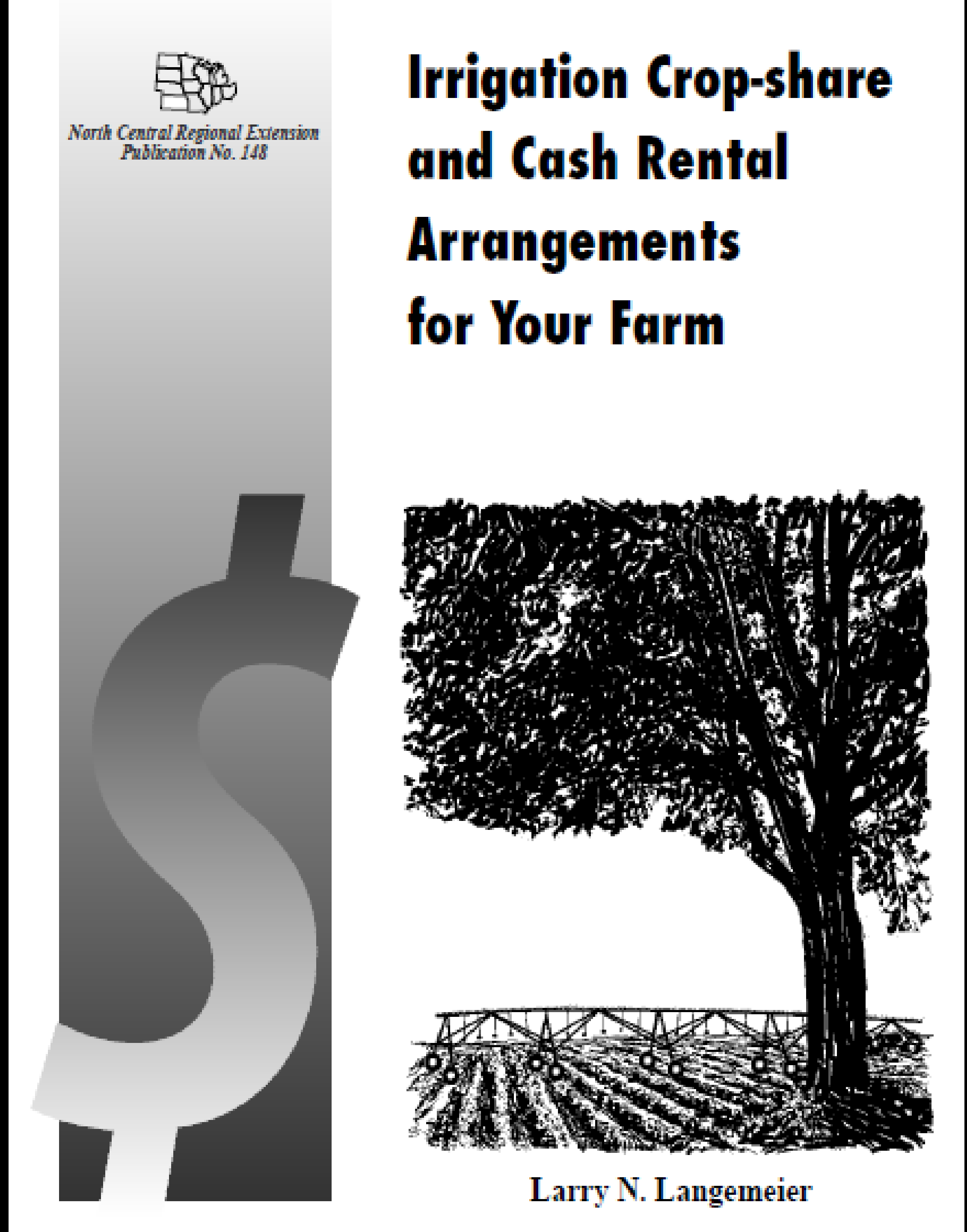
*To be recorded when improvement is completed.

Source: Langemeier (1996)

Importance of Written Lease

- Longer term implies need for lease to be in writing to be enforceable (Statute of Frauds)
- Need for additional provisions
- Increased importance of other provisions
- What if lease agreement is silent on a particular issue (or evidence unconvincing)?
  - Apply existing law, if any
  - Two issues
    - May impose burden on landowner or tenant that they would not have willingly accepted
    - There may be little or no existing law and/or its application to the issue may be unclear

Lease Form



North Central Regional Extension
Publication No. 148

Irrigation Crop-share and Cash Rental Arrangements for Your Farm

Larry N. Langemeier

Irrigation & Leasing Resources

- UNL Extension in Lancaster County
  - http://lancaster.unl.edu/ag/crops/irrigate.shtml
- Michigan State University Extension in St. Joseph County
  - http://www.msue.msu.edu/portal/default.cfm?pageset_id=28706&page_id=361029&msue_portal_id=25643

Thank You!
Questions?