



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.

The material in this publication was originally included in "PB 1597: Cropland Leasing Considerations," written by Rebecca G. Bowling, assistant Extension specialist; Delton C. Gerloff, associate professor; Jimmy C. Castellaw, area specialist; Samuel C. Danehower, area specialist; and Richard C. Lacy, associate area specialist in the Department of Agricultural and Resource Economics. Additional contributions were made by Paul Denton, professor emeritus, Department of Plant Sciences. The information has been revised and updated by Jane Starnes, research associate, and Christopher D. Clark, associate professor.

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.

- **Hybrid Lease** — Hybrid leases involve some combination of fixed cash rent, flexible cash rent and/or crop-share leases. For example, rent could include both a fixed minimum payment and a percentage of gross sales above some amount. This combination of a fixed and flexible cash lease allows the landlord and tenant to share risks while guaranteeing the landlord a minimum fixed payment and a bonus if sales or production are more than a specified amount. These arrangements are more complex and should always be put in writing.

Selecting a Type of Lease

To select the type of lease that is best suited to their circumstances, landowners and tenants should carefully consider a number of different factors. Both must determine the contributions of labor, capital and management skill they are willing and able to provide. They also must decide what production and price risks each party will bear. Making these determinations will give a general indication of which type of agreement is most appropriate.

In addition, the type of lease chosen may affect how the landowner's income from the lease is taxed and, depending on the landowner's age, his or her social security benefits. Income received under a cash lease is considered unearned income. Likewise, income from crop-share or livestock-share rental arrangements for landlords who are not materially participating in the farming operation is not classified as earned income. However, if the rental income is produced under a crop- or livestock-share lease by which the lessor is materially participating under the lease, the income could be classified as earned. Landowners who have concerns regarding tax implications should consult with a qualified tax professional before signing a lease.

Oral vs. Written Leases

While leases for one year or less may be oral or written, **written leases are highly preferable**. Oral leases for a term longer than one year are generally not enforceable. Thus, multiyear leases must be in writing to be enforceable. Written leases should be considered an accepted business practice and not an indication of distrust or lack of confidence in the other party.

Some of the advantages of having a written lease agreement are as follows:

- The act of putting a leasing arrangement in writing can help force landlords and tenants to consider and

explicitly agree to a more complete set of terms for the leasing arrangement.

- A written lease provides a valuable guide in case either party becomes physically or mentally incapable (or just forgetful).
- A written lease provides documentation for tax purposes, such as proof of rental income or rental expenses.

A carefully planned, written lease can help prevent future misunderstandings or conflict and provide a means to handle problems or disagreements should they develop.

Lease Provisions

All leases should (a) provide a reasonably accurate description of the land and/or buildings to be leased; (b) identify the landowner (often referred to as landlord or lessor) and tenant (or lessee); (c) specify a rental rate or a procedure for calculating the rent; (d) designate the time and place where payment of the rent is to be made; (e) state a definite time period over which the lease is to extend; and (f) be signed by both parties.

The farm may be described legally and/or by address or popular name ("Ben Jones Farm," for example). Additional descriptions can include the distance and direction from town, the road on which the farm is located and/or the rural mail route. Hand-drawn maps can be attached to the lease to identify specific fields if something less than an entire farm is being leased. If the actual total acreage leased is not specified and only an estimate is provided, the terms of the lease should make clear that the number is only an estimate.

Rental rates and arrangements for payment are an important part of any lease. The lease should stipulate not only the type of lease (cash or crop-share) and the rental rate or calculation, but also when the rent is to be paid and any penalties for late payments. Cash rent is often paid after the crop is harvested or livestock is sold but can be split into two or more parts, some of which could be payable prior to planting. Share rents are paid at harvest or when the crop is sold after expenses and revenue are documented.

The duration of the lease can be any length of time agreeable to the parties involved. Most farmland leases are in effect for at least one year. Very few have a term of more than five years. It is often in the interest of both parties for a lease to run at least three years so a tenant can justify needed expenditures for items such as lime, herbicides for problem weeds and soil conservation practices, all of which should lead to higher yields and income for both parties.

Advantages of Multiyear Leases

Improved Tenure Security — A lease of several years provides tenure security for the tenant, encouraging the adoption of long-term conservation practices that decrease soil erosion, build soil nutrients and maintain farm structures.

- *Reduced Transaction Costs* — When considering the length of the lease term, attention also should be given to transaction costs and social capital or goodwill. A year-to-year lease requires renegotiation each year, which generally involves providing a yearly notice to terminate. This not only costs time and money but also could decrease the trust and goodwill between the parties. A multiyear lease, while requiring more initial effort and planning, can provide built-in adjustments for rent, eliminating the need for termination and renegotiation. It also creates longer-term relationships, which encourages trust and ease of communication.

Disadvantages of Multiyear Leases

- *Effect on Renegotiating the Rent and Other Terms* — One of the primary reasons landowners avoid the use of a long-term lease is to allow for renegotiation of the lease terms each year, particularly those regarding the rent. Landowners also often favor a short-term lease when the rental rate is a fixed cash payment. Specifying a fixed cash rent can be risky for both parties in a long-term lease. Rapid changes in commodity or livestock prices, production costs and inflation rates can make a fixed cash rent unfair to one of the parties during a multiyear lease.
- *Effect on the Market Value of the Property* — Another reason landowners hesitate to enter a long-term lease is that the lease may hinder the landowner's ability to sell the land. The presence of a lease does not legally prevent the landlord from selling the land, but the sale may be subject to the lease. If so, the new owner would be required to honor the terms of the lease agreement. One way to handle this issue is to include a clause in the lease that would allow the landowner to terminate the lease in the event the land is sold.
- *Entering a Lease With an Untested Tenant* — Landowners also have legitimate fears about establishing a long-term lease with an untested, new tenant. After all, not all tenants have the same values or the same knowledge, skills, management style and equipment. While providing secure land tenure is important for the promotion of sustainable practices, it does not benefit the landowner or the land to have a tenant who does not live up to the agreement.

No lease or other legal document can address all possible problems. However, a lease should anticipate as many problems and developments as possible and spell out how they are to be handled. The following provisions address issues common to leasing arrangements and are worthy of consideration for inclusion in a farm lease.

- **Land use practices.** Landowners who are interested in maintaining or improving soil productivity should specify a land use and cropping program in the lease, especially if it is a multiyear lease. Consideration should be given to soil type, slope and susceptibility to erosion to determine land suitable for row crop production. Restrictions concerning cropland use may include rotations, limitation of crops grown or livestock raised, and cultural and mechanical practices to be used.
- **Farm operating expenses.** Under a cash leasing arrangement, all of the production costs are typically paid by the tenant. However, crop-share leases involve a sharing of operating expenses among the landowner and the tenant. For these arrangements, the landowner and tenant should discuss, agree upon and carefully specify the share of production costs that are to be paid by each party (i.e., fertilizer, pesticides, seed, equipment).
- **Rights and privileges.** The rights and privileges of each party with respect to the leased premises should be clearly stated in the lease. The following are some specific provisions that are commonly included in farmland leases:
 - The landowner should be granted the right to enter upon and inspect the leased premises but not to unreasonably interfere with the tenant's use of the property. Without this provision, some courts have held the landowner to be a trespasser if he or she enters the leased premises.
 - The lease should describe how improvements or the construction of temporary buildings or fences by the tenant are to be handled. Is the tenant allowed to make improvements or erect temporary buildings or fences? If improvements are made, will the tenant be compensated or the lease terminated? Will the tenant be allowed to remove improvements at the end of the lease term?
 - Agreements regarding other property rights or subleases, such as crop residue grazing, crop residue removal (such as corn stover), fishing, hunting, recreation and forestry land, should be specified in the lease.
- **Maintaining records.** If the agreement is a share lease, at least one party will need to keep records. The recordkeeping requirements may be minimal, especially

if the landowner does not share in the crop production expenses. The tenant should probably keep the records since he or she is closer to day-to-day farm operations. A cash lease also should provide that records will be maintained and made available by the tenant to the landowner. Production records, for example, are necessary in determining the level of government program payment support, and the landowner should have access to those records.

- **No partnerships.** Shared leases should explicitly provide that the parties do not intend to operate as a partnership or joint venture. Leasing arrangements in which the landowner shares in production expenses and returns and/or management decisions could be construed as a partnership or joint venture, legally obligating the partnership and each party to be responsible for the debts and obligations of the partnership.
- **Settling differences.** Most matters involving differences of opinion can generally be settled by discussion. If differences of opinion between the two parties cannot be settled easily, the lease can provide that the parties will attempt to consult disinterested persons (usually three) to settle differences in a friendly manner rather than through legal proceedings.
- **Default.** Leases often include provisions spelling out remedies in the event that either party fails in a substantial way to carry out the terms of the lease. These provisions generally allow the defaulting party a reasonable time to cure their nonpayment after they have been notified by the other party. Some leases allow the party who is not in default to step in and cure the default if the nonpaying party fails to do so. Reasonable costs and expenses incurred also can be charged.

Another common remedy is to allow the party who is not in default to terminate the lease by serving a

written notice that cites the areas of default and the effective date of termination (usually several days after the notice is served). Landowners should use caution when terminating a lease, however, as it can limit their ability to collect rent for the remainder of the lease term. Finally, it should be noted that landowners in Tennessee have statutory liens on growing crops to secure rent payments.

- **Additional agreements and modifications.** It is often necessary to change or add to existing agreements. Any changes made after the original lease is signed also should be made in writing and signed by both parties, even when both parties are in oral agreement.

Summary

Leasing will continue to be a popular way for farmers to gain access to land in Tennessee. As an increasing number of landowners are removed from the complexities of agriculture, the possibility for misunderstandings arising from oral lease arrangements is increasing. Thus, the use of written leases is becoming even more important. Two parties considering a farmland lease arrangement should fully consider the options and terms of their agreement and put the agreement in writing. Doing so can greatly reduce the likelihood of confusion or misunderstanding. In addition, a good written lease will reduce the potential for conflicts between a landowner and a tenant by setting forth the rights, duties and responsibilities of each party.

This publication provides educational information and guidelines for landlords and tenants to consider when entering into a lease or negotiating a lease agreement. If legal advice or other professional assistance is required, the services of a competent professional should be sought.

More information on the types of leases and other leasing topics can be found in the Farmland Legacy Leasing Series, which is located at <http://www.farmlandlegacy.org>.

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