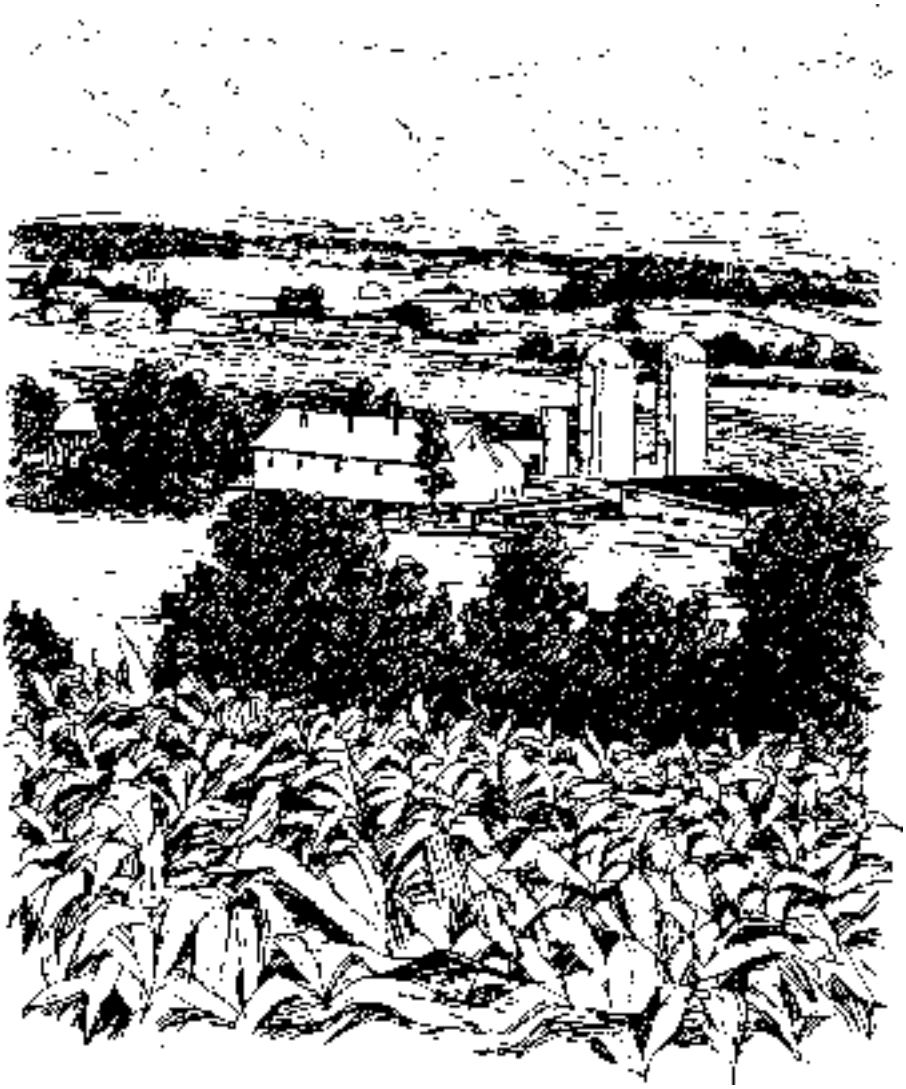
North Central Regional Extension Publication No. 75

Fixed and Flexible Cash Rental Arrangements for Your Farm



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Other North Central Regional publications in this series:

NCR-105, *Crop-share or Crop-share/Cash Rental Arrangements for Your Farm*
NCR-107, *Livestock Share Rental Arrangements for Your Farm*
NCR-148, *Irrigation Crop-share and Cash Rental Arrangements for Your Farm*
NCR-149, *Pasture Rental Arrangements for Your Farm*
NCR-214, *Rental Agreements for Farm Machinery, Equipment, and Buildings*

The following NCR lease forms also are available:

NCR-77, *Crop-share or Crop-share/Cash Farm Lease*
NCR-76, *Cash Farm Lease (with Flexible Provisions)*
NCR-106, *Irrigation Crop-share or Crop-share/Cash Farm Lease*
NCR-108, *Livestock-share Farm Lease*
NCR-109, *Pasture Lease*
NCR-215, *Farm Machinery, Building, or Equipment Lease*

Fixed and Flexible Cash Rental Arrangements for Your Farm

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Contents

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The kind of rental arrangements for cropland vary widely in each locality and from one geographic area to another. What is desirable or fair for one particular landlord/tenant relationship is not acceptable for others. The purpose of this publication is to help tenants and landlords develop fair cash-rent arrangements and assist them in making sound decisions based on a fair evaluation of resources. The first section addresses whether a fixed cash-rent lease arrangement should be used. Part II discusses how to develop a fair fixed cash rental rate, while Part III provides information on setting rent for other cropland, pasture, and buildings. Part IV outlines the advantages and disadvantages of flexible cash-leasing arrangements. Part V discusses the importance of developing a written lease agreement. A sample lease form also is included.

Part I
Should You Be Using a Fixed Cash-rent Arrangement?

Landlords and tenants can choose from several types of rental arrangements. In addition to cash rent, the lease agreement can be a crop-share or crop-share/cash arrangement. In addition to leasing, the landlord may hire custom operators to do the field work or "direct operate" by hiring labor to operate the owner's machinery.

There are both advantages and disadvantages to cash-rent arrangements. Some points to consider in deciding whether the fixed cash rental arrangement fits your situation are outlined in the following discussion.

Advantages of Cash Renting — Landlord

1. Less (perhaps none) managerial input is required than with other leasing arrangements.
2. Reduced involvement in management reduces the possibility of friction between the landlord and tenant concerning management decisions.
3. Concern over accurate division of crops and expenses is reduced or eliminated.
4. The landlord does not have to handle the marketing of crops. However, the landlord will not receive additional profits due to high yields or prices.
5. Fixed cash rent lessens the landlord's concern over variations in prices and yields. The tenant bears all price, cost, and production risks.
6. Income under the lease does not constitute self-employment income subject to Social Security tax and will not reduce Social Security benefits in retirement.

Disadvantages of Cash Renting — Landlord

1. A cash-rent amount acceptable to both parties can be difficult to determine.
2. Once a cash-rent rate is set, a change in the rental rate may be difficult to negotiate due to changes in prices and costs.
3. In average or above-average years, the landlord may receive less net income than from crop-share rent.
4. The landlord has fewer opportunities for income tax management. Under a crop-share arrangement and cash reporting of taxable income, the amount of taxable income can be shifted from one year to another through timing of crop sales before or after the end of the year. Similarly, purchase of fertilizer, seed, or other inputs for the next growing season can be made in the closing months of any tax year to reduce taxable income.
5. There may be an increased danger that the tenant will "mine" the land. However, competition for land and appropriate requirements in a written lease can minimize this problem.
6. The landlord has little opportunity to build a base for Social Security payments because of the difficulty in establishing acceptable evidence of material participation. This may not be a concern to retired landlords however.
7. To value the farmland in the landlord's estate at its use value rather than its fair-market value for estate tax purposes, the following two requirements must be met:
   (a) Before the landlord dies, a cash-rent lease can only be to a member of the landlord's family as the tenant.
   (b) After death, the heirs must not cash lease the use-value land; not even to a family member.
8. Eligibility for paying federal estate tax in installments over 15 years after death could be jeopardized. Land rented under a cash-rent lease does not constitute an interest in a closely held business, which the decedent must have at the time of death to be eligible to pay federal estate tax in installments. Only crop-share or livestock-share leases qualify as an interest in a closely held business.

Advantages of Cash Renting — Tenant

1. The tenant has a relatively free hand in making management decisions.
2. Friction between the tenant and landlord is minimized because of the landlord's reduced participation in management.
3. The tenant has more incentive to strive for high yields.

4. The tenant can benefit from any windfall profits from unexpected crop price increases or unusually high yields.
5. The tenant does not need to divide crops or income from sale of crops nor keep special records on expenses for the landlord as required under a crop-share lease.

Disadvantages of Cash Renting — Tenant

1. Increased risk from price and yield variations. Cash rent is a fixed cash expense that may be very difficult to pay in a poor crop year or with very low crop prices.
2. Cash rental rates tend to trend upward as crop yields increase, even though most of the yield increases may be a result of managerial skills. In addition, rental rates do not immediately decline with decreases in crop yields or prices.

Part II
Establishing a Fair Fixed Cash Rental Rate

If the decision is to rent for cash, how is a fair rental rate determined for the farm or field in question? There are four methods that can be used to establish a fixed cash rent for a particular farm or field: (1) cash-rent market approach, (2) landlord's cost or desired-return approach, (3) landlord's net-share rent approach, and (4) the amount a tenant can afford to pay.

The following discussion and worksheet examples are related to cash renting a farm.

The concepts and approaches outlined in this publication are the same whether cash renting of a field or total farm is being considered. In some cases, the landlord and tenant may only want to consider cash rent for a specific crop.

Cash-rent Market Approach

This method requires knowledge of cash rents being paid for farms in the area. Adjustments should be made for differences in the productivity of the farm and the amount and quality of improvements.

This approach has some disadvantages. It may be difficult to determine actual cash rents being paid for comparable farms as well as any adjustments that need to be made in the rental rates. Other approaches may be more sophisticated, yet better reflect a specific situation. The rates determined by any method cannot deviate greatly from the prevailing market rates if those rates are to be seriously considered in the final bargaining process.

Landlord's Ownership Cost or Desired Return

Under this approach, the landlord calculates the cost of resource ownership or establishes the type the property. Worksheet 1 provides an example of the required computations. Some points to remember in deriving these ownership costs are

Land: Land is valued at its current fair-market value for agricultural purposes. Location near cities and other nonagricultural influences on value is ignored. The value of land may include the value of such assets as buildings, improvements, and certain irrigation equipment.

Interest on land: A practical "bargaining" rate of interest tends to be approximately 5 to 7 percent for two primary reasons:

1. The current value of real estate is used rather than the purchase price.
2. Upon sale of the farm, the net dollars available to loan out at a higher rate of interest would be lower than the fair market value because of income taxes and sale expenses.
3. Historic returns to land have been in the 4- to 6-percent range as an annual return above all charges, except land.
4. Returns to owning land may include capital gains as well as the annual income from renting land.

Note: Cash rental rates for the area can be used to estimate the annual land charge.

Real estate taxes: Actual real estate taxes paid on the land and improvements should be used.

Land development: The average dollars spent annually for lime, conservation practices, and other land improvements should be used.

Irrigation equipment: Depreciation, interest, repairs, taxes, and insurance charges on irrigation equipment should be utilized. Estimate the average useful life of the irrigation equipment as the basis for determining annual depreciation charge. Interest charge is on one-half the investment value. Use actual annual repair, insurance, and taxes if known; or use a percentage of investment value.

Note: Do not include taxes if already included in real estate.

Buildings and improvements: Depreciation, interest, repairs, taxes, and insurance charges on buildings and improvements should be utilized to the extent used in the trade or business of farming. Estimate the average useful life of the buildings and improvements as a basis for determining annual depreciation charge. Interest charge is on one-half the investment value. Use actual annual repair, insurance, and taxes if known; or use a percentage of investment value.

Note: Do not include taxes if already included in real estate tax.

Other: If a lot of capital has been invested to improve land productivity, such as drainage, then include a reasonable depreciation allowance for this investment. Tile lines are depreciable as 15-year property.

Landlords will seldom receive enough cash rent to cover total ownership costs. Consequently, this method may result in an extremely high value; but the method does give the landlord a basis for setting the "asking price" in cash-rent negotiations.

Landlord's Adjusted Net-share Rent

This method for computing cash rent assumes the rent value should be related to crop-share rent. Normally, fixed cash rents are expected to be lower than net crop-share rent since the landlord shifts all price and weather risk to the tenant. The difference represents the tenant's compensation for carrying the added risk.

Cash rents are not always less than crop-share rents. If there is a strong demand for land in an area, cash rents may exceed net crop-share rents. This explains why landlords are sometimes reluctant to change from cash rent to crop-share arrangements.

If this method is utilized, an average net crop share over a period of years should be used to allow for both good and bad yields. Landlords who have rented on a share basis in previous years are likely to know the percentage of crop share received.

Worksheet 2 will help the landlord who does not know what the average net-share rent has been. Use yield and cost values that can be realistically expected for the current year and typical share arrangements for the community or area in determining the landlord's share of income and expenses.

Once the net-share rent value has been determined or estimated, the landlord and tenant must decide how to adjust this value for price and weather risk assumed by the tenant. Determination of the risk value is a matter for negotiation. In the example, the risk value was set equal to 7.5 percent of total crop receipts.

Tenant's Net Return to Land

In the desire to farm more land, tenants may at times bid more for land than they can actually afford. Hence, tenants need to carefully figure how much money will actually be available to pay for the use of land after variable expenses, fixed costs on machinery, and a return to labor and management have been deducted from the gross value of crops. Worksheet 3 outlines a procedure to estimate how much can be paid for land in the form of cash rent.

Worksheet 1. *Landlord Ownership Costs as Basis for Fixed Cash Rent*

Crops grown: Corn, soybeans, wheat **Acres:** 320 **Year:** 1996

Item	Total Per-acre Value		Rate or Life	Per-acre Annual Charge
1. Land	$ 1,250.00			
Interest		x	.06	$ 75.00
Real estate tax		x	.005	$ 6.25
2. Land (development)	$			
Interest		x	.06	$
Real estate tax		x	.05	$
3. Irrigation equipment	$			
Depreciation [1]		÷	1 yrs.	$
Interest [2]		x	.05	$
Repairs		x	.01	$
Insurance, taxes		x	.0025	$
4. Buildings	$ 235.00			
Depreciation [1]		÷	30 yrs.	$ 7.83
Interest [2]		x	.05	$
Repairs		x	.01	$ 2.35
Insurance, taxes		x	.0025	$ 0.59
5. Other items	$ 45.00			
Fences [1]		÷	25 yrs.	$ 1.80
Water system		x	.05	$
_____		x	.01	$ 0.45
_____		x	.0025	$ 0.11
6. Total cash or desired return				$ 94.38

[1] Years of life will vary for buildings, fences, and different types of irrigation equipment.

[2] Do not compute an interest charge if value of buildings, improvements, and certain irrigation equipment are included in value of land.

[3] Do not include taxes on buildings, improvements, and certain irrigation equipment if taxes on these assets are included in real estate tax.

The values for labor and management may be the most difficult to determine. The labor value used should reflect the amount of time used only for crop production and general farm maintenance. The hourly rate should equal what could be earned if working for other farmers in the area. Management is sometimes valued at 5 to 10 percent of gross value of crops, or 1.5 to 2.5 percent of the investment in land, equipment, and machinery.

If livestock production involving rented buildings or facilities is a major portion of the operation, the tenant may want to follow a similar procedure to determine how much cash rent can be paid for the use of those facilities.

What's a Fair Cash Rent?

The Bargaining Process

A final cash rent figure acceptable to both tenant and landlord can be derived from more than one of the methods outlined in this publication. They should identify areas of agreement and differences based on the values each has independently developed. To aid in this process, Table 1 summarizes the example values derived from the different methods.

Negotiation provides a means of arriving at a rate that is acceptable to both and is an opportunity for them to understand each other's point of view. Negotiations should begin only after the contributions of each party are known and information is provided on local leasing arrangements.

Both parties need to recognize that pressing an advantage too far can result in an unfair arrangement for one or the other. A lease that is unfair to either party is unlikely to last. An unfair, lopsided arrangement tends to encourage dishonesty and poor cooperation from the disadvantaged party. Over time, changes may occur, and "the shoe may be on the other foot."

Table 1. *Comparison of Results When Different Approaches Are Used*

	Examples	You
Adjusted average cash rent in area	$ 85.00	$ _____
Landlord's cost and desired return (Worksheet 1)	$ 94.38	$ _____
Landlord's adjusted net share rent (Worksheet 2)	$ 82.41	$ _____
Amount tenant could afford to pay (Worksheet 3)	$ 71.48	$ _____

Worksheet 2. *Converting Landlord's Net-share Rent to Cash Rental Rate* [1]

Landlord's share of gross crop value

			Landlord's share				
Crops	Acres	Yield per acre [2]	Percent of crop	Tons or bushels	$ per ton or bushel [3]	Total value	Per-acre value
Corn	195	125	40	9,750	2.50	$ 60,937.50	xxx
Soybeans	60	45	40	1,080	5.85	$15,795.00	xxx
Wheat	45	45	40	810	3.10	$ 6,277.50	xxx
Gov't paym'ts	– –	$7,595	40			$ 7,595.00	xxx
Set-aside, waste	20					– –	xxx
A. TOTAL CROP RECEIPTS	320					$90,605.00	$ 283.14

Landlord's share of shared expenses [2]

Crops	Fert.	Harvest drying	Irrigat'n fuel	Herb., insect.		Total cost	Per-acre cost
Corn	$2,450	$585		$2,660		$ 5,695	xxx
Soybeans	335			640		$ 975	xxx
Wheat	325			80		$ 405	xxx
Set-aside, waste					$ 80	$ 80	xxx
						$	xxx
B. TOTAL CROP EXPENSES						$ 7,155	$ 22.36

Landlord's crop rent (A - B) ..... $ 90.90

Less risk shifted to tenant ..... $ 8.49

Net landlord's share rent per acre ..... $ 82.41

[1] If whole farm leased on a cash-rent basis, list all crops grown, income from each crop, and shared expenses for each crop.

[2] Use average yields, allowing for both good and bad years. Incorporate trends in yields.

[3] Use current prices and costs. Include government payments in price or as separate line.

Part III

Establishing Rents for Other Cropland, Pasture, and Buildings

Other cropland: See the following publications: NCR-105, *Crop Share or Crop-share/Cash Rental Arrangements for Your Farm*, and NCR-148, *Irrigation Crop-share and Cash Rental Arrangements for Your Farm*.

Pasture: See NCR-149, *Pasture Rental Arrangements for Your Farm*. The per acre, per head, or total rent for pasture should be entered as part of the cash rent lease, along with the stocking rate and any other restrictions.

House: The house should be rented for an amount based on the market rate for the area. The house is sometimes provided free to the tenant. Tenant and landlord should agree on payment of utilities and maintenance costs. If the house is rented out to someone working on the farm, it is a farm building depreciable over 20 years. Otherwise, it is depreciable residential property and is depreciated over a 27.5-year period.

Service buildings: Service buildings can be divided into two classes — useful and nonuseful buildings. The nonuseful buildings should not be included in the lease. An example would be an old chicken coop that is useless to the tenant.

Useful buildings contribute to the farm operation through grain, hay, or machinery storage or livestock production. The rental value should give the landlord a return on the building's investment.

Worksheet 3. *Amount of Cash Rent Tenant Can Afford to Pay* [1]

Gross value of crops produced

Crops	Acres	Yield per acre [2]	Price per ton or bushel [3]	Total value	Per-acre value
Corn	195	125	$2.50	$60,937.50	xxx
Soybeans	60	45	$5.85	$15,795.00	xxx
Wheat	45	45	$3.10	$ 6,277.50	xxx
Gov't Paym'ts	– –	– –	– –	$ 7,595.00	xxx
Set-aside, waste	20	– –	– –	– –	xxx
A. Total Crop Value	320			$90,605.00	$283.14

Total variable costs [3]

Crops	Acres	Total variable costs per acre	Total variable costs	Per-acre costs
Corn	195	$158	$30,810.00	xxx
Soybeans	60	$ 97	$ 5,820.00	xxx
Wheat	45	$ 86	$ 3,870.00	xxx
Set-aside, waste	20	$ 10	$ 200.00	xxx
				xxx
B. Total Variable Costs	320	xxx	$40,700.00	$127.19

Total fixed costs, labor, and management [3]

Crop machinery costs: machinery value per acre	$ 270.00	
Depreciation for 10 years	$ 27.00	
Interest on avg. investment at 10 percent	$ 13.50	
Taxes at ____ percent	$	
Insurance at .25 percent	$ 0.68	
C. TOTAL FIXED COSTS		$ 41.18
D. LABOR CHARGE [4] (2.45 hrs/acre @ $ 9.00 /hr)		$ 22.05
E. MANAGEMENT CHARGE (7.5 percent of total crop value)		$ 21.24
F. TOTAL PRODUCTION COSTS (B + C + D + E)		$ 211.66
G. AMOUNT THAT CAN BE PAID FOR CASH RENT PER ACRE (A - F)		$ 71.48

[1] If whole farm leased on a cash-rent basis, list crops grown, income from each crop, and variable expenses for each crop.

[2] Use average yields, allowing for both good and bad years. Incorporate trends in yields.

[3] Use current prices and costs. Include government payments in price or as a separate line. Variable costs include fuel, oil, repairs, fertilizer, herbicide, insecticide, interest on operating costs, custom hire, drying, insurance, and miscellaneous costs. See a local or state Extension office for *Farm Management Budgets.*

[4] Labor expense or charge may be included in variable expenses.

The return should be based on the following ownership costs: depreciation, interest, repairs, taxes, and insurance (the "DIRTI five"). Table 2 can be used to determine the rental value for each useful building. See NCR-214, *Rental Agreements for Farm Machinery, Equipment, and Buildings*.

Table 2. *Service Building Rental Charge*

Item	Annual charge
Building _____	
Investment $_____	
Depreciation _____ yrs	$_____
Interest _____ %	$_____
Repairs _____ %	$_____
Taxes _____ %	$_____
Insurance _____ %	$_____
Total rental value	$_____

Part IV
Putting Flexibility in the Cash-rent Arrangement

Farm commodity prices and operational expenses are often uncertain. Thus, tenants and landlords hesitate to commit to a fixed cash rent, especially for more than one year. Tenants fear a fixed cash rent could pose a real hardship if commodity prices decline or if poor growing conditions reduce yields. Landlords believe it is unfair for the tenant to reap all the benefits from a sharp rise in crop prices. At the same time, neither party wants a crop-share leasing arrangement. Therefore, the tenant and landlord may turn to the use of flexible cash rents of one kind or another. For example, a cash lease with a rent-adjustment clause.

The idea of flexing cash rent usually pertains only to the rent charged for cropland. Rents for buildings, for other farmstead facilities, or for comparatively minor acreages of pasture, hay, and woodland should be on a fixed basis even though the rent for cropland varies. Both landlord and tenant need to agree on the amount of "non-flexible" rent at the beginning of the lease period.

Advantages and Disadvantages of Flexible Cash Renting

A flexible cash-rent arrangement for cropland has certain advantages and disadvantages.

Advantages:

1. Flexible cash rent enables the landlord to share in the additional income that results from unexpected increases in the prices of crops considered in the rent-adjustment clause. If the cash rent also is flexed for changes in yields, the landlord will benefit from above-normal yields regardless of the cause.
2. For the tenant, risk is reduced. Cash-rent expense is lower if crop prices or yields are less than normal.

Disadvantages:

1. For the landlord, flexible cash rent increases risk.
2. Windfall profits that may be realized by the tenant from unexpected price increases are reduced.
3. If cash rent is flexed according to yield, the landlord becomes more concerned with the level of crop yields as well as the accuracy of reported yields.
4. If cash rent is flexed according to yield, the tenant may give up part of the benefits from higher yields resulting from managerial input, thus reducing incentives to do the best possible job.
5. Calculating flexible cash rent can be more difficult.

Different Methods of Flexing Cash Rent

Cash rents are flexed primarily by: (1) Flexing for changes in crop price only or (2) flexing for both crop price changes and yield variations. Few, if any, methods provide for flexing cash rents in response to sharp, unexpected changes in the cost of purchased inputs. Thus, flexible cash rents should be reexamined periodically to determine if adjustments are needed due to changes in input costs.

Some methods of determining flexible cash rents are outlined in the following discussion.

Flexing for Crop Price Only

One flexible cash rent approach allows for flexing the cash rent for only changes in the crop price. Several "price only" options are available, with five different methods outlined in the following discussion.

Base rent multiplied by ratio of current year's price to base price. The tenant and landlord should agree at the beginning of the leasing period on a base rent and a base price if this method is used. For example, the tenant and landlord might agree that the base cash rent would be $82.50 per acre and the "base price" of corn at $2.50 a bushel. If the "current year's price," equal to the average closing price at Anytown Elevator during the period September 15 to November 1, is $2.80, the current year's cash rent would be calculated as follows:

base rent x current year's price ÷ base price

($82.50 x $2.80 ÷ $2.50 = $92.40)

Fixed amount of commodity. An example of this method of flexing cash rent is to set the rent equal to the value of a given quantity (bushels, tons, pounds, etc.) of the primary crop. The price used for determining this value would be based on price quotations at a particular location and period. For example, if the primary crop were corn,

the lease might state the following: " The amount of the cash rent shall be equal to the value of 10,000 bushels of corn based on the average daily closing price at the Anytown Elevator during the period September 15 to November 1." The location and time period to be used for determining the price should be agreed upon in advance and stated in the lease agreement. With this method, cash rent flexes as crop price changes.

Base rent with stated adjustments for prices outside a specified range. Under this approach, the tenant and landlord agree on a base cash rent that applies as long as the current year's price is within a specified range. For example, the tenant and the landlord might agree on a cash rent of $82.50 per acre if the current year's corn price is in a $2.40 to $2.60 range. For each $0.10 change in the corn price above or below the stated range of prices, the cash rent would increase or decrease correspondingly by a stated number of dollars such as $5.00 per acre. Thus, if the price of corn for the current year (determined in the same manner as for the first two methods) was $2.80 per bushel, the cash rent would be $82.50 + (2 x $5) or $92.50 per acre. If the price of corn for the current year were $2.10 per bushel, then the cash rent would be $82.50 – (3 x $5) or $67.50 per acre.

Base rent with stated adjustments for price changes. This approach is very similar to the preceding method except the base cash rent applies only when the current year's price is *exactly* equal to the stated single base price. No range of prices is permitted before a change in cash rent takes place. An adjustment agreed on at the beginning of the lease year would be made for any change in the price of corn or other crops above or below the base prices agreed upon.

Minimum base rent with upward adjustments. With this method, the tenant and landlord agree on a minimum cash rent for normal yields and a relatively low crop price. For example, both parties might agree that with an average yield of 125 bushels per acre and a $2.00 per bushel corn price, the cash rent would be $65 per acre. Also, the cash rent would increase by an agreed-upon amount (such as $5) for each $0.10 per bushel increase in price. Thus, if the current year's price was $2.75 per bushel, then the cash rent would be $65 + (7.5 x $5) or $102.50.

Flexing for Price and Yield

This method requires the tenant and landlord to agree on a base cash rent tied to a base yield (average or normally expected yield) and a base expected price for each crop being considered. If only one crop is grown, this is the only crop considered. If several crops are grown and all are considered equally important, all crops may be considered in determining the current year's cash rent. If one crop accounts for most of the income or is planted on most of the land, the cash rent might be adjusted according to changes in price and yield of the one crop even though other minor crops are produced.

The adjustment for yield changes could be made according to changes in published county yield data or in line with changes in the yields on the particular farm being leased. When county yields are used, the base cash rent is adjusted each year by multiplying the base rent by the ratio of the published county average yield to the base yield agreed to by the tenant and landlord. When farm yields are used, the base cash rent is adjusted by multiplying the base cash rent by the ratio of the current year's yield to the average or expected base yield for the farm.

Generally, it is advisable not to use the county yields for making year-to-year adjustments for at least two reasons: (1) Final calculations of the current year's cash rent can not be made until the county average yields are known. This fact could cause a considerable delay in computing the rent. Cash rent for a given year might not be finalized until the next year is well under way. This would be a serious problem if there is a change in tenants. (2) Yields on the farm being rented could be lower than normal in a particular year while the average county yield might actually be higher than the base yield.

If farm yields are used in adjusting the year-to-year cash rent, the exact details of how the current year's yield is to be measured should be stated in the lease agreement. Is the yield measured in terms of volume in storage at the close of harvest? Total weight? Harvested samples? Are adjustments made for moisture? If yield is measured by volume, when will the volume be determined? Immediately after harvest? Some stated number of days after harvest? If volume is used, what considerations will be given to test weight?

The lease agreement also should specifically state how the current year's price is to be determined. The time and place to be used for determining the current year's price should be agreed upon at the beginning of the agreement.

Assume the same facts as presented in the first discussion of "flexing for price only." Base cash rent of $82.50; base corn price of $2.50; and a base yield of 125 bushels per acre. After harvest, the actual corn price turns out to be $2.80 per bushel (average closing price at Anytown Elevator dur-

ing the period September 15 to November 1). The actual yield is determined to be 140 bushels per acre for the current year.

The formula for the calculation of the cash rent would be as follows:

base rent x current year's yield ÷ base yield x current year's price ÷ base price

($82.50 x 140 ÷ 125 x $2.80÷ $2.50 = $103.49)

Stated percentage of the current crop's value. With this method, the tenant and landlord need to agree at the beginning how to determine the current year's yield and price. Both parties need to agree on the percentage share of the crop used for calculating the actual amount of rent. The tenant and landlord should outline in detail in the lease agreement how yield and price will be determined. The formula for determining each year's cash rent is:

current year's yield x current year's price x agreed upon percentage

This method is very similar to a crop-share agreement except for the inclusion of price.

Minimum base rent plus a percentage of increased value. With this method, the tenant and landlord must agree upon a minimum base rent for the field or farm or a per-acre dollar figure. The dollar figure would be based on a normal yield and a very low price. This value can be determined in the same manner as fixed cash rent. The tenant and landlord must agree upon a detailed procedure for determining the current year's crop value. To do this, a method must be decided on how to establish the current year's yield and price. Both parties have to agree upon what percentage of the increased value over and above the base rent would be considered rent. Again, these details should be worked out at the beginning of the leasing period and included in the lease agreement.

This method operates as follows: Suppose both parties agree on a base cash rent of $82.50 per acre, assuming normal yield of 125 bushels per acre and a corn price of $2.50 per bushel. They also agree the cash rent will increase by 30 percent of any increase in crop value above $312.50 per acre. To illustrate, if the price of corn increased to $2.80 per bushel and the yield to 130 bushels, the cash rent would be increased to $97.95 per acre. This cash-rent value is calculated as follows:

$2.80 x 130 = $364;
$364 – $312.50 = $51.50;
$82.50 + (.30 x $51.50) = $97.95

Incorporate Flexible Provisions in Written Lease

If it is decided to use some form of flexible cash rent, the details of the methodology should be clearly specified in a written lease agreement. The calculation of flexible cash rent is more complicated to figure and easier to forget. The example lease included in this publication includes a page designed for two of the methods for flexing rent discussed in the preceding sections. If some other method of flexing cash rent is preferred, the method should be described in detail in "Method III" of the agreement. Whatever the method of flexing cash rent used, the method should be described in writing and included as section IV-C in the total lease agreement.

Part V
Putting the Agreement in Writing

A copy of a cash-rent lease agreement form is included in this publication. Some of the advantages of a written agreement are:

1. It encourages a detailed statement of the agreement that assures a better understanding by both parties.
2. It serves as a reminder of the items originally agreed upon.
3. It provides a valuable guide for the heirs if either the tenant or landlord dies. By statute of frauds, interest in real estate generally must be in writing.

The agreement should be carefully reviewed each year to ensure the terms of the agreement are still applicable and desirable.

Every lease should include certain items. These are the names of the parties involved, an accurate description of the property being rented, the beginning and ending dates of the agreement, the amount of rent to be paid, a statement of how and when the rent is to be paid, and the signatures of the parties involved.

These minimal provisions alone, however, fail to meet the requirements of a good lease. These provisions provide no guidance on how the land is to be used, nor do they outline possible problem areas and solutions.

A good lease should clearly identify the property being rented. If the landlord wishes to reserve the use of certain improvements on the land, these reservations should be clearly stated in the lease.

Absent a statutory or constitutional limitation, the duration of the lease can be any length of time agreed upon by the parties. Most leases are for at least one full year. Tenants sometimes request leases for more than one year particularly if they must invest more capital in equipment or improvements needed on the farm being rented.

In general, most transactions involving real estate require a contract in writing to be enforceable. In most states, oral leases for not more than a year are enforceable.

Landlords, as well as tenants, should enter long-term leases only after very careful consideration. Remember that the lease is a contract — a contract that "marries" the parties to undesirable and desirable provisions alike. Long-term leases commit both parties to each other for the length of the lease. Often it is better to include an automatic renewal clause and a provision for compensation for inexhausted improvements made by the tenant.

Long-term leases specifying a fixed cash rent are particularly risky because of unpredictable commodity prices and uncertain costs of operation. Landlords should be wary of long-term leases because they can to be a "one-way street."

Cash renting gives the tenant a comparatively free hand to decide what crops to grow and the number of acres of each crop. Even so, the landlord and tenant should have an understanding to be used for row crops, small grains, and legumes. This fact is particularly true if the land is subject to wind or water erosion. Both parties also should have a specific understanding of how much silage may be grown and the maximum number of cattle or other livestock that may be grazed on existing pasture.

Generally, it is desirable to set the dates for paying the cash rent to coincide with sales of crops or livestock. Paying more than one installment also may be desirable. For example, one-half the lease payment at the time the lease agreement is signed and the other one-half payment at the time crops are sold. Several smaller payments can help the tenant from a cash-flow standpoint while better meeting the needs of the landlord who may be dependent on the farm rental income for family living expenses.

The sample lease contained in this publication provides for most concerns of both the tenant and landlord. The parties can cross out or omit unwanted provisions. (Be sure both parties initial these lease changes.) But, before provisions are eliminated, the landlord and tenant should remember that one of the functions of a written lease is to anticipate possible developments and to state how to handle such problems if they actually do develop.

Worksheet 1. *Landlord Ownership Costs as Basis for Fixed Cash Rent*

Crops grown: **Acres:** **Year:**

Item	Total Per-acre Value		Rate or Life	Per-acre Annual Charge
1. Land	$_____			
Interest		x	_____	$_____
Real estate tax		x	_____	$_____
2. Land (development)	$_____			
Interest		x	_____	$_____
Real estate tax		x	_____	$_____
3. Irrigation equipment	$_____			
Depreciation [1]		÷	_____ yrs.	$_____
Interest [2]		x	_____	$_____
Repairs		x	_____	$_____
Insurance, taxes		x	_____	$_____
4. Buildings	$_____			
Depreciation [1]		÷	_____ yrs.	$_____
Interest [2]		x	_____	$_____
Repairs		x	_____	$_____
Insurance, taxes		x	_____	$_____
5. Other items	$_____			
Fences [1]		÷	_____ yrs.	$_____
Water system		x	_____	$_____
_____		x	_____	$_____
_____		x	_____	$_____
6. Total cash or desired return				$_____

[1] Years of life will vary for buildings, fences, and different types of irrigation equipment.

[2] Do not compute an interest charge if value of buildings, improvements, and certain irrigation equipment are included in value of land.

[3] Do not include taxes on buildings, improvements, and certain irrigation equipment if taxes on these assets are included in real estate tax.

Worksheet 2. *Converting Landlord's Net-share Rent to Cash Rental Rate* [1]

Landlord's share of gross crop value

			Landlord's share				
Crops	Acres	Yield per acre [2]	Percent of crop	Tons or bushels	$ per ton or bushel [3]	Total value	Per-acre value
						$	xxx
						$	xxx
						$	xxx
						$	xxx
						$	xxx
A. Total Crop Receipts						$	$

Landlord's share of shared expenses [2]

Crops	Fert.	Harvest drying	Irrigat'n fuel	Herb., insect.		Total cost	Per-acre cost
						$	xxx
						$	xxx
						$	xxx
						$	xxx
						$	xxx
B. Total Crop Expenses						$	$

Landlord's crop rent (A - B) ..... $ _____

Less risk shifted to tenant ..... $ _____

Net landlord's share rent per acre ..... $ _____

[1] If whole farm leased on a cash-rent basis, list all crops grown, income from each crop, and shared expenses for each crop.

[2] Use average yields, allowing for both good and bad years. Incorporate trends in yields.

[3] Use current prices and costs. Include government payments in price or as separate line.

Worksheet 3. *Amount of Cash Rent Tenant Can Afford to Pay* [1]

Gross value of crops produced

Crops	Acres	Yield per acre [2]	Price per ton or bushel [3]	Total value	Per-acre value
					xxx
					xxx
					xxx
					xxx
					xxx
A. Total Crop Value					$

Total variable costs [3]

Crops	Acres	Total variable costs per acre	Total variable costs	Per-acre costs
				xxx
				xxx
				xxx
				xxx
				xxx
B. Total Variable Costs		xxx		$

Total fixed costs, labor, and management [3]

Crop machinery costs: machinery value per acre ..... $ _____
Depreciation for ___ years ..... $ _____
Interest on avg. investment at ___ percent ..... $ _____
Taxes at ____ percent ..... $ _____
Insurance at ____ percent ..... $ _____

C. TOTAL FIXED COSTS $ _____
D. LABOR CHARGE [4] (_____ hrs/acre @ $ _____ /hr) $ _____
E. MANAGEMENT CHARGE (____ percent of total crop value) $ _____

F. TOTAL PRODUCTION COSTS (B + C + D + E) $ _____
G. AMOUNT THAT CAN BE PAID FOR CASH RENT PER ACRE (A - F) $ _____

[1] If whole farm leased on a cash-rent basis, list crops grown, income from each crop, and variable expenses for each crop.

[2] Use average yields, allowing for both good and bad years. Incorporate trends in yields.

[3] Use current prices and costs. Include government payments in price or as a separate line. Variable costs include fuel, oil, repairs, fertilizer, herbicide, insecticide, interest on operating costs, custom hire, drying, insurance, and miscellaneous costs. See a local or state Extension office for *Farm Management Budgets.*

[4] Labor expense or charge may be included in variable expenses.

Cash Farm Lease (with Flexible Provisions)

North Central Regional
Publication No. 76 [1] (Revised 1997)

This CASH FARM LEASE form can provide the landlord and tenant with a guide for developing an agreement to fit their individual situation. This form is not intended to take the place of legal advice pertaining to contractual relationships between the two parties. Because of the possibility that a farm operating agreement may be legally considered a partnership under certain conditions, seeking proper legal advice is recommended when developing such an agreement.

This lease entered into this _____ day of _____ , 19 _____ , between

_____, landlord, of _____

_____
(address)

_____ , spouse, of _____

_____
(address)

hereafter known as "the landlord," and

_____ , tenant, of _____

_____
(address)

_____ , spouse, of _____

_____
(address)

hereafter known as "the tenant."

I. PROPERTY DESCRIPTION

The landlord hereby leases to the tenant, to occupy and use for agricultural and related purposes, the following described property: _____

_____

_____

_____

consisting of approximately _____ acres situated in _____ County (Counties), _____ (State) with all improvements thereon except as follows: _____

_____

_____

_____

_____

II. GENERAL TERMS OF LEASE

A. Time period covered. The provisions of this agreement shall be in effect for _____ year(s), commencing on the _____ day of _____, 19_____. This lease shall continue in effect from year to year thereafter unless written notice of termination is given by either party to the other at least _____ days prior to expiration of this lease or the end of any year of continuation.

B. Review of lease. A written request is required for a general review of the lease or for consideration of proposed changes by either party, at least ____ days prior to the final date for giving notice to terminate the lease as specified in II-A.

C. Amendments and alterations. Amendments and alterations to this lease shall be in writing and shall be signed by both the landlord and tenant.

D. No partnership intended. It is particularly understood and agreed that this lease shall not be deemed to be, nor intended to give rise to, a partnership relation.

E. Transfer of property. If the landlord should sell or otherwise transfer title to the farm, such action will be done subject to the provisions of this lease.

F. Right of entry. The landlord, as well as agents and employees of the landlord, reserve the right to enter the farm at any reasonable time to: a) consult with the tenant; b) make repairs, improvements, and inspections; and c) (after notice of termination of the lease is given) do tillage, seeding, fertilizing, and any other customary seasonal work, none of which is to interfere with the tenant in carrying out regular farm operations.

G. No right to sublease. The landlord 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.

H. Binding on heirs. The provisions of this lease shall be binding upon the heirs, executors, administrators, and successors of both landlord and tenant in like manner as upon the original parties, except as provided by mutual written agreement.

I. Additional provisions:

_____

_____

_____

_____

_____

_____

_____

[1] For cash and flexible rental information see *Fixed and Flexible Arrangements for Your Farm*, NCR publication number 75.

III. LAND USE

A. General provisions. The land described in Section I will be used in approximately the following manner. If it is impractical in any year to follow such a land-use plan, appropriate adjustments will be made by mutual written agreement between the parties.

1. Cropland
   a) Row crops _____ Acres
   b) Small grains _____ Acres
   c) Legumes _____ Acres
   d) Rotation pasture _____ Acres
2. Permanent pasture _____ Acres
3. Other: _____ _____ Acres
   _____ _____ Acres
   _____ _____ Acres

TOTAL ACRES _____ Acres

B. Restrictions. The maximum acres harvested as silage shall be _____ acres unless it is mutually decided otherwise. The pasture stocking rate shall not exceed:

PASTURE IDENTIF.	ANIMAL UNITS/ACRE
_____	_____
_____	_____
_____	_____

(1000-pound mature cow is equivalent to one animal unit.)

Other restrictions are:

_____
_____
_____
_____

C. Government programs. The extent of participation in government programs will be discussed and decided on an annual basis. The course of action agreed upon should be placed in writing and be signed by both parties. A copy of the course of action so agreed upon shall be made available to each party.

IV. AMOUNT AND PAYMENT OF RENT

(If a flexible cash rental arrangement is desired, use material on the last page of this form and omit section A below.)

A. Cash rental rates. The tenant agrees to pay as cash rent the amount as calculated below for each kind of land; or, one total may be entered for ENTIRE FARM UNIT.

Amount of Cash Rent

Kind of land or improvements	Acres	Rate per Acre	Amount
Row crops	____	$ _____	$_____
Small grains	____	$ _____	$_____
Legumes	____	$ _____	$_____
Permanent pasture	____	$ _____	$_____
Timber	____	$ _____	$_____
Waste	____	$ _____	$_____
Farm buildings	XXXX	XXXX	$_____
Dwelling	XXXX	XXXX	$_____
Other	____	$ _____	$_____
ENTIRE FARM	____	XXXX	$_____

B. Rental payment. The annual cash rent shall be paid as follows:

$ _____ on or before _____ day of _____ (month)
$ _____ on or before _____ day of _____ (month)
$ _____ on or before _____ day of _____ (month)
$ _____ on or before _____ day of _____ (month)

If rent is not paid when due, the tenant agrees to pay interest on the amount of unpaid rent at the rate of _____ percent per annum from the due date until paid.

C. Rental adjustment. Additional agreements in regard to rental payment: _____
_____
_____

V. OPERATION AND MAINTENANCE OF FARM

In order to operate this farm efficiently and to maintain it in a high state of productivity, the parties agree as follows:

A. The tenant agrees:

1. General maintenance. To provide the labor necessary to maintain the farm and its improvements during the rental period in as good condition as it was at the beginning. Normal wear and depreciation and damage from causes beyond the tenant's control are excepted.
2. Land use. Not to: a) plow pasture or meadowland, b) cut live trees for sale or personal use, or c) pasture new seedings of legumes and grasses in the year they are seeded without consent of the landlord.
3. Insurance. Not to house automobiles, trucks, or tractors in barns, or otherwise violate restrictions in the landlord's insurance policies without written consent from the landlord. Restrictions to be observed are as follows: _____
   _____
   _____
   _____
4. Noxious weeds. To use diligence to prevent noxious weeds from going to seed on the farm. Treatment of the noxious weed infestation and cost thereof shall be handled as follows: _____
   _____
   _____
   _____
5. Addition of improvements. Not to: a) erect or permit to be erected on the farm any nonremovable structure or building, b) incur any expense to the landlord for such purposes, or c) add electrical wiring, plumbing, or heating to any building without written consent of the landlord.
6. Conservation. Control soil erosion according to an approved conservation plan; keep in good repair all terraces, open ditches, inlets and outlets of tile drains; preserve all established watercourses or ditches including grassed waterways; and refrain from any operation or practice that will injure such structures.
7. Damages. When leaving the farm, to pay the landlord reasonable compensation for any damages to the farm for which the tenant is responsible. Any decrease in value due to ordinary wear and depreciation or damages outside the control of the tenant are excepted.

8. Costs of operation. To pay all costs of operation except those specifically referred to in Sections V-A-4 and V-B.

9. Repairs. Not to buy materials for maintenance and repairs in an amount in excess of $ _____ within a single year without written consent of the landlord.

B. The landlord agrees:

1. Loss replacement. To replace or repair as promptly as possible the dwelling or any other building or equipment regularly used by the tenant that may be destroyed or damaged by fire, flood, or other cause beyond the control of the tenant or to make rental adjustments in lieu of replacements.

2. Materials for repairs. To furnish all material needed for normal maintenance and repairs.

3. Skilled labor. To furnish any skilled labor tasks that the tenant is unable to perform satisfactorily. Additional agreements regarding materials and labor are: _____
_____
_____

4. Reimbursement. To pay for materials purchased by the tenant for purposes of repair and maintenance in an amount not to exceed $ _____ in any one year, except as otherwise agreed upon. Reimbursement shall be made within _____ days after the tenant submits the bill.

5. Removable improvements. Let the tenant 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. The landlord further agrees to let the tenant 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.

6. Compensation for crop expenses. To reimburse the tenant at the termination of this lease for field work done and for other crop costs incurred for crops to be harvested during the following year. Unless otherwise agreed, current custom rates for the operations involved will be used as a basis of settlement.

C. Both agree:

1. Not to obligate other party. Neither party hereto shall pledge the credit of the other party hereto for any purpose whatsoever without the consent of the other party. Neither party shall be responsible for debts or liabilities incurred, or for damages caused by the other party.

2. Capital improvements. Costs of establishing hay or pasture seedings, new conservation structures, improvements (except as provided in Section V-B-5), or of applying lime and other long-lived fertilizers shall be divided between landlord and tenant as set forth in the following table. The tenant will be reimbursed by the landlord either when the improvement is completed, or the tenant will be compensated for the share of the depreciated cost of the tenant's contribution when the lease ends based on the value of the tenant's contribution and depreciation rate shown in the "Compensation for Improvements" table. (Cross out the portion of the preceding sentence which does not apply.) Rates for labor, power and machinery contributed by the tenant shall be agreed upon before construction is started.

VI. ARBITRATION OF DIFFERENCES

Any differences between the parties as to their several rights or obligations under this lease that are not settled by mutual agreement after thorough discussion, shall be submitted for arbitration to a committee of three disinterested persons, one selected by each party hereto and the third by the two thus selected. The committee's decision shall be accepted by both parties.

Table 1— Compensation for Improvements

Type of improvement	Date to be completed	Estimated total cost ($)	% contributed by tenant			Total value of tenant's contrib. ($)*	Rate of annual depreciation (%)
			Material	*Unskilled labor*	*Mach.*		

*** To be recorded when improvement is completed.**

AMOUNT OF RENT TO BE PAID WHEN CROPLAND IS RENTED ON A FLEXIBLE BASIS.

A. Cash rent for inflexible items (complete at beginning of lease period)
   a. Pasture ..... $ _____
   b. Hayland ..... $ _____
   c. Other inflexible cropland ..... $ _____
   d. Timber, wasteland ..... $ _____
   e. Farmstead ..... $ _____
   TOTAL INFLEXIBLE RENT ..... $_____

B. Flexible cropland rent (from method I, II, or III below) ..... $_____

C. TOTAL RENT FOR YEAR ..... $_____

D. Flexible cropland rent (use method I, II, or III)

1. BASIC INFORMATION TO BE USED IN METHODS I AND II

Crop(s)	Base cash rent (per acre)	Base yield (bu or ton/acre)	Base price (per bu or per ton)	Min. cash rent (per acre)	Max. cash rent (per acre)
_____	$ _____	_____	$ _____	$ _____	$ _____
_____	$ _____	_____	$ _____	$ _____	$ _____
_____	$ _____	_____	$ _____	$ _____	$ _____

2. THE CURRENT PRICE FOR THE CURRENT YEAR SHALL BE AVERAGE PRICE AT CLOSE OF DAY BASED ON THE FOLLOWING TIME PERIOD(S) AND LOCATION(S)

Crop(s)					Price source
_____	_____ Day	_____ Month	through _____ Day	_____ Month	at _____
_____	_____ Day	_____ Month	through _____ Day	_____ Month	at _____
_____	_____ Day	_____ Month	through _____ Day	_____ Month	at _____

FOR EACH YEAR OF THIS LEASE, THE PER-ACRE BASE CASH RENT FOR EACH CROP SHALL BE ADJUSTED AT THE CLOSE OF THE CROPPING SEASON BY ONE OF THE FOLLOWING METHODS:

METHOD I — FLEXING FOR PRICE ONLY

Crop(s)	Base rent	x (Current price ÷ Base price)	= Rent/acre [1]	x Acres grown	= Adj. rent for year
_____	$_____	x $ _____	= $ _____	x _____	= $ _____
_____	$_____	x $ _____	= $ _____	x _____	= $ _____
_____	$_____	x $ _____	= $ _____	x _____	= $ _____
				Total all crops	= $ _____

METHOD II — FLEXING FOR PRICE AND YIELD

Crop(s)	Base rent	x (Current price ÷ Base price)	x (Current yld [2] ÷ Base yld)	= Rent/acre [1]	x Acres grown	= Adj. rent for year
_____	$_____	x $ _____	x $_____	= $_____	x _____	= $ _____
_____	$_____	x $ _____	x $_____	= $_____	x _____	= $ _____
_____	$_____	x $ _____	x $_____	= $_____	x _____	= $ _____
					Total all crops	= $ _____

METHOD III — WORK OUT AND RECORD PROCEDURE TO BE USED.

_____
_____
_____
_____

---

[1] If calculated figure is less than "Min. cash rent" in D-1, use the set minimum. If calculated figure is more than "Max. cash rent" in D-1, use the set maximum.

[2] The current yield shall be the "farm" yield for the current lease year.

Executed in duplicate on the date first above written:

_____ (tenant)

_____ (landlord)

_____ (tenant's spouse)

_____ (landlord's spouse)

STATE OF _____
COUNTY OF _____ } SS:

On this _____ day of _____ , A.D. 19_____ , before me, the undersigned, a Notary Public in said State, personally appeared _____ , _____ , _____ , and _____ to me known to be the identical persons named in and who executed the foregoing instrument, and acknowledged that they executed the same as their voluntary act and deed.

_____
Notary Public

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