

Fixed-Cash Crop Lease Agreements

Quick Notes...

The tenant produces crops on the land and makes general management decisions as if the land were owned by the tenant.

The risks for the tenant are greater with a fixed-cash lease agreement than with crop share lease agreements.

The types of land rental agreements vary widely in each locality and from one farming area to another, and are often based on long-standing traditions. Landowners and tenants can choose from three primary types of lease agreements for crop production: crop share, fixed-cash, or flexible-cash lease agreements.

The purpose of this publication is to help landowners and tenants make informed decisions and to develop "fair" fixed-cash lease agreements concerning crop production. A sample fixed-cash lease agreement can be found at the end of this document.

What Is A Fixed-Cash Lease Agreement?

A lease is basically an agreement that gives the use of an asset to a lessee for a specific period of time at a specified rate. A lease does not transfer title of ownership nor an

equity interest in the asset. Labeling a document as a lease does not necessarily mean it is a lease according to the Internal Revenue Service (IRS). Questions concerning the IRS treatment of a lease should be addressed by your tax management professional. Also, the legalities of the lease should be addressed by professional legal counsel.

A fixed-cash lease is a rental agreement in which the landowner receives a predetermined cash fee from the tenant irrespective of crop yields or product prices. The tenant produces crops on the land and makes general management decisions as if the land were owned by the tenant.

Advantages of a fixed-cash lease agreement over other types of agreements include:

1. The landowner has less managerial input than with other lease agreements reducing the possibility or likelihood of friction between the landowner and tenant.
2. There is little concern over accurate division of the crop and expenses and marketing.
3. The tenant has great freedom in crop production, marketing, and

participation in government programs.

4. Cash rents reduces the likelihood that the landowner will be considered a "participating landlord" when calculating social security payments.

Disadvantages of a fixed-cash lease agreement over other types of agreements include:

1. It may be difficult to determine a cash rent acceptable to both parties.
2. Cash rents are likely to be too low in times of high yields and prices and too high when yields and prices are low.
3. The tenant may tend to "mine" the land, thus reducing productivity over time.
4. Cash rents become fixed costs for the tenant.

Developing A Fair Fixed-Cash Lease Agreement

There are four primary methods that can be used to establish a fixed-cash rent for a particular farm: (1) cash rent market approach; (2) landowner's cost or desired return approach; (3) landowner's net share rent approach; and (4) tenant's ability to pay approach. Regardless of the approach used, the landowner and tenant will probably bargain to a final rental rate.

Cash Rent Market Approach: This method requires knowledge of cash rents being paid for lands in the area.

Adjustments should be made to the rent to account for differences in productivity of the land, use of improvements, and other factors of the rental arrangement.

Landowner's Cost Or Desired Return

Approach: This method requires the landlord to calculate land ownership costs (the DIRT five -- depreciation, interest, repairs, taxes, and insurance) or establish the kind of return he wishes to receive on the investment. The worksheet on the next page can be used to help calculate these costs.

It is important to recognize that landlords seldom receive enough rent to cover total ownership costs of buildings and improvements. Consequently, this method may result in an unrealistically high figure, especially if the farm is highly improved. Nevertheless, it does give the landowner a basis for setting an "asking price" in cash rent.

Landowner's Adjusted Net Share Rent

Approach: This method presumes that cash rents should be related to share rents. Normally, fixed cash rents are expected to be lower than net share rents since the landowner shifts price and weather risks to the tenant. With strong demand for land and for various other reasons, cash rents in some areas may actually exceed net share rents.

The second worksheet shown on the next page can be used to help calculate a basis for cash rent. Use typical yields and costs for the area if more accurate values are unknown. Once the net share rent has been determined, the landowner and tenant must decide how much adjustment should be made to a fixed-cash rent.

WORKSHEET FOR HELPING CALCULATE LANDOWNER'S OWNERSHIP COSTS

Interest on Investment:

Acres _____ x Per Acre Price \$ _____ = Value \$ _____ @ _____ % = \$ _____
 Repairs (average annual): \$ _____
 Taxes: \$ _____
 Insurance: \$ _____

Depreciation on Improvements

Buildings: Value \$ _____ ÷ estimated life _____ years \$ _____
 Fences: Value \$ _____ ÷ estimated life _____ years \$ _____
 Water System: Value \$ _____ ÷ estimated life _____ years \$ _____
 _____ Value \$ _____ ÷ estimated life _____ years \$ _____
 Total Costs of Desired Return \$ _____
 Per Acre (Total Costs \$ _____ ÷ Acres rented _____) \$ _____

WORKSHEET FOR CALCULATING LANDLORD'S NET SHARE RENT

I. Landlord's Share of the Crop

| | | | | | | | | | | |
|-------|---|-------|---|-------------|---|-------|---|-------|---|-------------|
| ACRES | X | YIELD | = | TOTAL YIELD | X | % | X | PRICE | = | TOTAL VALUE |
| | | | | | | SHARE | | | | |

II. Landlord's Share of Expenses

| | | | | | | | | | | | | |
|------|---|------------|---|-----------|---|-------|---|---------|---|-------|---|----------------|
| SEED | + | FERTILIZER | + | CHEMICALS | + | WATER | + | HARVEST | + | OTHER | = | TOTAL EXPENSES |
|------|---|------------|---|-----------|---|-------|---|---------|---|-------|---|----------------|

III. Net Crop Rent

| | | | | | | | | | | | | |
|-------------|---|----------------|---|-----|---|-------|---|---------------|---|------------|---|----------------|
| TOTAL VALUE | - | TOTAL EXPENSES | = | NET | ÷ | ACRES | = | RENT PER ACRE | + | ADJUSTMENT | = | EST. CASH RENT |
|-------------|---|----------------|---|-----|---|-------|---|---------------|---|------------|---|----------------|

Tenant's Ability To Pay Approach: This method determines fixed-cash rents on the tenant's projected return above production costs, using anticipated yields and prices. Subtracting all costs and a return for labor and management from gross income leaves a figure that approximates the maximum rent the tenant can afford to pay.

Any (or more than one) of the four approaches can be used to negotiate a fixed-cash rent acceptable to both the landowner and tenant. The bargaining process provides a means of arriving at a rent acceptable to all involved parties, and an opportunity for

everyone to understand the others' point of view. Intelligent bargaining can only occur if the landowner and tenant each knows what is being contributed by each party.

Putting The Agreement In Writing

It is highly desirable to put the terms of a lease agreement in writing. A written lease agreement enhances understanding and communication between all involved parties, serves as a reminder of the terms originally agreed upon, and provides a valuable guide for the heirs if either the landowner or tenant dies.

Every lease agreement should include certain items -- 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 being paid and when and how it is to be paid, and the signatures of the parties involved. Furthermore, other provisions (such as the rights and responsibilities of both parties) which provide for most of the concerns of both the landowner and tenant.

Sources: "Fixed and Flexible Cash Rental Arrangements For Your Farm", North Central Regional Extension Publication 75.

Notes... Network (For More Information) Contact: **Jeff Tranel, CSU Cooperative Extension, 2200 Bonforte Blvd., Pueblo, CO 81001 (719) 549-2049**

Fixed-Cash Crop Lease Agreement

This fixed-cash crop lease agreement form is designed to 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.

Section 4, No. 4.7a

PARTIES INVOLVED

This lease is entered into this _____ day of _____, 19____ between _____, landlord, of _____ (address) and _____, tenant, of _____ (address) hereafter known as the landlord and the tenant, respectively.

PROPERTY DESCRIPTION

The landlord hereby leases to the tenant, to occupy and use for agricultural and related purposes, the following describe d property: _____ consisting of approximately _____ acres situated in _____ County, Colorado with all improvements thereon except as follows: _____.

GENERAL TERMS OF THE LEASE

- A. Time period covered. The provisions of this agreement shall commence on the _____ day of _____ (month), 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 _____ days prior to the anniversary date of the lease in any year of continuation.
- B. Amendments and alterations. A written request is required for general review of the lease or for consideration of proposed changes by either party _____ days prior to the anniversary date of the lease in any year of continuation. Amendments and alterations to this lease shall be (1) in writing, (2) signed by both the landlord and the tenant, and (3) attached to all copies of this lease.
- C. 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. Neither party shall have the right to bind the other without written consent.
- D. Transfer of property. If the landlord should sell or otherwise transfer title to the farm, the landlord will do so subject to the provisions of this lease.
- E. No right to sublet. 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 whomever.
- F. Binding on heirs. The provisions of this lease shall be binding upon the heirs, executors, administrators and successors of both the landlord and the tenant in like manner upon the original parties except as provided by mutual written consent.
- G. Compensation for crop expenses. The landlord shall reimburse the tenant at the termination of this lease for field work completed and for other crop costs incurred for crops to be harvested during the following year. Unless otherwise mutually agreed, current custom rates for the operations involved shall be used as a basis for settlement.

AMOUNT AND PAYMENT OF RENT

- A. Rental Payment. The annual cash rent shall be paid as follows:
\$ _____ on or before the _____ day of _____ (month),
\$ _____ on or before the _____ day of _____ (month),
\$ _____ on or before the _____ day of _____ (month),
\$ _____ on or before the _____ day of _____ (month).

B. Rent payments shall be made to the landlord at the following location: _____
_____.

C. 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, including that day, until the date paid.

D. Additional agreements in regard to rental payment are: _____.

IMPROVEMENTS

A. The costs of establishing hay or pasture, new conservation structures, or improvements (except as identified in other sections of this lease) shall be divided between the landlord and the tenant as follows: _____
_____.

B. The tenant agrees to provide the unskilled labor necessary to maintain the farm and its improvements during the tenant's tenancy 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.

The landlord agrees to furnish all materials and skilled labor needed for normal maintenance and repairs to the farm and its improvements. The landlord shall pay for material purchased by the tenant for such maintenance and repairs in the 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 to the landlord.

C. The tenant shall not (1) erect or permit to be erected on the farm any non-removable structure or building; (2) incur any expense to the landlord for such purposes; or (3) add electrical wiring, plumbing, or heating to any building without written consent of the landlord.

D. The landlord shall replace or repair as promptly as possible the dwelling or any other building regularly used by the tenant that may be destroyed or damaged by fire, flood, or other cause beyond the control of the tenant.

E. The tenant may 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 agrees to let the tenant remove such improvements even though they are legally fixtures at any time this lease is in effect. The tenant shall have no right to compensation for improvements not removed except as mutually agreed.

OPERATION AND MAINTENANCE OF THE FARM

A. In order to operate the farm efficiently and maintain it in a high state of productivity, the tenant agrees to use diligence to prevent noxious weeds from going to seed on the farm. Treatment of noxious weed infestation and cost thereof shall be paid _____ percent by the landlord and _____ percent by the tenant.

B. The tenant agrees to control soil erosion as completely as practicable; to keep in good repair all terraces, open ditches, and drains; and to preserve all established water sources.

C. The tenant agrees to not plow permanent pasture, cut live trees for sale or personal use, or pasture new seedlings of legumes and grasses in the year they are planted.

D. The tenant agrees to farm the land in such a manner as meets government agency (such as Natural Resource Conservation Services and Consolidated Farm Services Agency) regulations. The farm is covered in a cooperative agreement between the landlord and _____ Soil Conservation District, and the tenant agrees to operate the farm in accordance with the complete soil conservation and land use plan prepared under said cooperative agreement.

E. The landlord shall replace or repair as promptly as possible the dwelling or any other building regularly used by the tenant that may be destroyed or damaged by fire, flood, or other cause beyond the control of the tenant.

ARBITRATION AND DIFFERENCES

A. 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 decisions shall be accepted by both parties.

B. If either party willfully neglects or refuses to carry out any material provision, the other party shall have the right, in addition to compensation for damage, to terminate the lease. Written notice shall be given to the party at fault specifying the violations of the agreement. If violations are not corrected within 30 days, the lease shall be terminated.

RIGHT OF ENTRY

The landlord reserves the right, in person or by agent, to enter the farm at any reasonable time to: (1) consult with the tenant; (2) make repairs, improvements, and inspections; and (3) after written notification of termination of the lease agreement, do plowing, seeding, fertilizing, and any other customary seasonal work, not of which is to interfere with the tenant's ability to carry out regular farm operations.

EXECUTION

This lease agreement shall be executed in duplicate on the date above written. A copy of this lease agreement and subsequent alteration, each with original signatures, shall be given to the landlord and to the tenant.

Landlord

Date

Landlord

Date

Tenant

Date

Tenant

Date