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Crop Cash Lease Agreements

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Any 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). This Extension Extra does not address any of the questions concerning the IRS treatment of a lease; if you have such questions, contact your tax management professional. Also, this Extra does not address any of the questions concerning the legalities of the lease that should be addressed by professional legal counsel.

A cash lease is a rental agreement in which the landowner receives a predetermined cash fee from the tenant regardless of crop yields or product prices. Thus, these types of leases are regarded as fixed-cash leases. 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 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 rent 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 an amount of 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 Rental Rate

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 need to bargain to a final rental rate.

1. Cash Rent Market Approach

This method requires knowledge of cash rents being paid for lands in the area. Readers can consult other publications in this series or go to the SDSU publication C271,

Agricultural Land Market Trends 1991-2006, which can be found on the internet at
http://agbiopubs.sdstate.edu/articles/C271.pdf

You are cautioned that adjustments will need to be made to current market rental rates to account for differences in productivity of the land, use of improvements, and other factors of the rental arrangement.

2. Landowner's Cost Or Desired Return Approach
This method requires the landlord to calculate land ownership costs (the DIRTI five—depreciation, interest, repairs, taxes, and insurance) or establish the kind of return he wishes to receive on the investment. The top of the worksheet at the end of this paper can be used to help calculate these costs.

Since landlords seldom receive enough rent to cover total ownership costs of buildings and improvements, 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.

3. Landowner's Adjusted Net Share Rent Approach
This method presumes that regardless of the type of rental agreement (fixed-cash payment or share of the crop), the amount of rent paid (received) should be approximately the same. Normally, fixed cash rents are expected to be lower than net share rents since the landowner shifts price and weather risks to the tenant, and the tenant should be compensated for assuming the additional risk by paying a lower amount of rent. With strong demand for land and for other reasons, cash rents in some areas may actually exceed net share rents.

The bottom part of the worksheet in this Extra can be used to help calculate a basis for cash rent. Use actual production history for the parcel of land being rented if the data is available. Otherwise, typical yields and costs for the area can be used. Once the net share rent has been determined, the landowner and tenant must decide how much adjustment to the fixed-cash rental rate is appropriate.

4. 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 is an opportunity for everyone to understand the other's point of view. Intelligent bargaining can only occur if the landowner and tenant each know what is being contributed by each party.

Put the Agreement in Writing

Both landlords and tenants are reminded that 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.

For some types of lease agreements, such as leases for longer than one year, South Dakota Codified Laws specify that the lease be written. Consult your attorney for guidance. Sample lease forms can be found elsewhere in this publication series.

Adapted for South Dakota from Fixed-Cash Crop Lease Agreements, Agriculture & Business Management Notes, Section 4, No. 4.7,Cooperative Extension, Colorado State University

EXEX5063. 2007. Access at http://agbiopubs.sdstate.edu/articles/ExEx5063.pdf.

Landowner's Ownership Costs Worksheet

Interest on Investment:

_______	X	$ __________	=	$ ____________	X	________%		=	$__________
Acres	X	Per-Acre Price	=	Value of land investment	X	interest rate			

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 _________ = $__________

Landlord's Net Share Rent Worksheet

Landlord's Share of the Crop

__________	X	_______	=	_________	X	______	X	______	=	__________
Acres	X	Yield	=	Total Yield	X	% Share	X	Price	=	Total Value

Landlord's Share of Expenses

_________	+	_________	+	_________	+	_________	+	_________	+	_________	=	__________
Seed	+	Fertilizer	+	Chemicals	+	Water	+	Harvest	+	Other	=	Total Expenses

Net Crop Rent

__________	–	__________	=	__________	÷	__________	=	__________	+	__________	=	___________
Total Value	–	Total Expenses	=	Net	÷	Acres	=	Rent Per Acre	+	Adjustment	=	Estimated Cash Rent