1-1-2007

# South Dakota Agricultural Rental Agreements: Farm Leasing Arrangements

Burton Pflueger
*South Dakota State University*

ExEx5062

South Dakota State University Cooperative Extension Service

SDSU

Extension Extra

College of Agriculture & Biological Sciences / USDA

# South Dakota Agricultural Rental Agreements: Farm Leasing Arrangements

Burton Pflueger, Extension economist

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: fixed cash payment, flexible cash payment, or payment via a share of the crop produced.  Custom farming may also be considered as an alternative to leasing land assets.

## Cash Farm Leases

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 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 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.

## Flexible Cash Leases

A flexible-cash lease agreement is a rental arrangement in which the landowner receives a predetermined cash fee from the tenant adjusted for changes in prices and/or yields. The tenant produces crops on the land and makes general management decisions as if the land were owned by the tenant.

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

1. The landowner has opportunities to share in the additional income resulting from unexpected increases in crop prices and extra-normal yields.
2. The tenant has less risk than with a fixed-cash lease. Rent expense is lower if prices and/or yields are below normal.

**Disadvantages of a flexible-cash lease** rent agreement over other types of agreements include:

1. Flexible-cash rent increases risk for both the landowner and tenant.
2. The tenant may have to give up some benefits from higher yields due to the owner's management input, thus reducing incentive to do the best possible job.
3. Flexible-cash rents are more difficult to calculate than are fixed-cash rents.

### Crop Share Leases

A crop share lease agreement provides for a specified percentage of the crop to go to both the landowner and the tenant. The basic premise is that each party receives income from the crop in proportion to what each party contributed to production.

**Advantages of a crop share lease** agreement over other types of agreements include:

1. Less operating monies may be tied up by the tenant because the landowner shares some production costs.
2. Management may be shared between an experienced landowner and tenant, resulting in more effective and financially rewarding decisions.
3. Crop sales and input purchases may be timed for improved tax management.
4. Risks of low yields and prices are shared between the two parties. Profits from high yields and/or prices are also shared.
5. Landowner "material participation" may be more easily proved when using government programs, for estate purposes, building a social security base, or for income tax purposes than under the various cash rental agreements.

**Disadvantages of a crop share lease** agreement over other types of agreements include:

1. Landowner income will be variable because of yield and price variations as well as changes in costs of shared inputs.
2. Accounting for shared expenses must be maintained.
3. The landowner must make marketing decisions.
4. Landowner and tenant must discuss annual cropping practices and other management issues.
5. As prices change, the lease should be reviewed for fairness. Sharing agreements may also need to be changed.

### Custom Farming

Many landowners are considering custom farming as an alternative to farming their land themselves or leasing to a tenant under a typical lease agreement.

Custom farming allows landowners to continue to manage their farms without the investment of major equipment, time, or other financial resources. This alternative allows landowners to retain close control of the farming business, make all of the farming decisions, and retain all income from sales without having to perform day-to-day activities or providing/investing in equipment and labor. Owners with small acreages can make most of the production and marketing decisions without investing in a full line of machinery. There are no lease payments to collect, since the owner receives the entire crop. The owner would usually be considered a material participant for tax purposes, and would be entitled to all government payments.

The custom operator needs no additional operating capital. Fuel, lubrication, and repairs are usually the only added costs. Custom farming offers a fixed return. Although the possibility of high repair bills poses some risk, this is minor compared with the price and yield risks faced by a tenant. The custom operator only receives payment for "farming" and does not benefit from increased yield and/or price in a "good year."

Information presented here is adapted from Crop Share Lease Agreements, Fixed Cash Crop Lease Agreements, Flexible Cash Crop Lease Agreements found on the internet at http://www.coopext.colostate.edu/ABM/abmndx.html and other sources.


EXEX5062. 2007. Access at http://agbiopubs.sdstate.edu/articles/ExEx5062.pdf.