



Farm Lease Letter

Letter No. 1

GOALS, ECONOMICS, LEGAL, SOIL CONSERVATION

July 2000

A wide range of goals and economic situations must be considered and carefully fit into the lease if the leasing situation is to be satisfactory for both landlord and tenant. Key responsibilities of each party include examination of the economic viability of the lease under varying production and price outcomes and careful examination of the goals they hope to achieve through the lease.

GOALS

The first step in structuring a lease situation is determining goals. It is important that each party to the lease identify the goals they hope to achieve and select or develop a lease, which is as compatible with these goals as possible.

These goals might include:

- highest potential return in both short and long run
- a fair return to each party based on the resources they provide to the business
- continuity of income from year to year
- meeting Conservation Compliance requirements
- a minimum of risk
- a tenant (landlord who they can work with year after year)

- a tenant who will take good care of the rented property
- freedom from management and marketing decisions

Landlords may seek a tenant with adequate capital to meet the needs of the business. Many tenants want to rent land, and perhaps, facilities of sufficient size to provide an adequate income--or the option of farming additional land.

In addition, many of the tenant's fixed costs are built around plans to farm a given amount of land. For this reason, security of tenure from year to year is often very important.

Goals vary a great deal between individual situations and need to be given careful consideration when selecting a lease type and developing the individual lease.

ECONOMICS

Once the goals of each party have been considered, the next step is that of developing a lease agreement which will combine the goals and resources of landlord and tenant into an economically acceptable package. The agreement should encourage use of the optimum levels of technology, capital, labor, and management for profitable operation of the farm

Consideration should also be given to yield and price risk and who will bear them. The question of what costs are borne by each party also needs to be answered.

Each alternate type of lease provides (1) a different proportion of contributions of capital, labor and management to be furnished by the landlord and by the tenant, (2) a different distribution of farm income, and (3) varying levels of risk to landlord and tenant. In addition, the costs of various contributions change in their relationship to each other from time to time. New methods may typically bring changes in costs. For these reasons, a given sharing of contributions and returns which was equitable at one time may not be satisfactory at another time and the rental terms may need to be revised periodically to keep them up to date.

The terms of a lease contract should be viewed in total to determine fairness to both parties involved. The treatment of individual provisions should contribute to the equity of the lease as a whole.

Several other factors also influence leasing terms: supply and demand for land, what is satisfactory to each party, the bargaining ability of each party, productivity of the resources, improvements and facilities, and custom.

The remaining newsletters in this series will discuss these factors in greater detail as they apply to various types of leases.

LEGAL

The lease should include at a minimum: the name and address of each party; the signature of each party; the period of time which the lease covers; description of what is being leased; the kind and amount of rent and time and place of payment; the division of payment; the division of expenses; and how the lease may be terminated.

A written lease is preferred. It helps to assure that the important factors are considered in developing the lease. It also provides a record of each party's rights and obligations to others under the lease. It is

good business practice to minimize misunderstanding. A written lease documenting the agreement can be helpful.

Preprinted lease forms are useful in negotiating. They serve as a list of items to be discussed that might otherwise be overlooked. Delete items that do not apply and add items that are a part of the agreement. The discussion process of "how would you suggest we handle this item" helps each party explore the compatibility with the other party and their goals.

Landowners can improve the security of payments by: asking the operator's lender for a subordination or a letter of credit; acquiring a security of payments or a letter of credit; acquiring a security interest under UCC article 9; or requiring cash payment at the beginning of the lease.

LEASE TERMINATION

According to Iowa law, farm tenancies continue for the following year with the same terms and considerations as the original lease unless a written notice of termination is given by either party to the other not later than September 1. Then the tenancy terminates the following March 1. Either party can terminate the lease by serving written notice on the other party. This provision doesn't prevent termination of the lease at any time by mutual agreement, nor does it prevent termination due to violation of terms of the rental agreement.

Writing of a successor lease automatically replaces a prior lease and makes termination of the expiring lease unnecessary.

Written notice is required to be given in one of three ways:

1. By delivery of the notice, on or before September 1, with acceptance of service to be signed by the party to the lease or a successor of the party, receiving the notice.
2. By serving the notice, on or before September 1, personally, or if personal service has been tried and cannot be achieved, by publication,

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on the same conditions, and in the same manner as is provided for the service of original notices, except that when the notice is served by publication no affidavit is required. Service by publication is completed on the day of the last publication.

3. By mailing the notice before September by certified mail. Notice served by certified mail is made and completed when the notice is enclosed in a sealed envelope, with the proper postage on the envelope, addressed to the party or a successor of the party at the last known mailing address and deposited in a mail receptacle provided by the United States postal service.

CONSERVATION CONSIDERATIONS

Several provisions of the Food Security Act of 1985 encouraged the reduction of soil erosion and the retention of wetlands. These provisions are known as the Conservation Reserve, Conservation Compliance, Sodbuster, and Swampbuster. These provisions are continued under the FAIR Act of 1996.

The Conservation Reserve offered producers help in retiring highly erodible cropland. The Farm Service Agency will share up to half of the cost of establishing permanent grasses, legumes, trees, windbreaks, or wildlife plantings on highly erodible cropland. Under 10-year contracts, FSA makes annual rental payments to you as long as the terms and conditions of the contract are met. The program is administered by the county FSA office. Contracts began to mature in 1995, requiring decisions on future uses.

Conservation Compliance applies to a farm that continues to plant row crops on highly erodible fields. Highly erodible land typically is that with a "C (5-9%) slope" or greater. Conservation compliance applied to land where annually tilled crops were grown at least once during the 1981-85 period and will apply to all highly erodible land in annual crop production by 1990. To remain eligible

for certain USDA program benefits, you must have developed and be actively applying a locally approved conservation plan for those highly-erodible fields by January 1, 1990. The plan was to be fully implemented by January 1, 1995. For conservation planning assistance, contact the local SCS Office.

Sodbuster applies if you or your tenant plant annually tilled crops on a highly erodible field that was not used for crop production during the 1981-85 period. If you plow out such a highly erodible field, you must do so under a conservation district plan approved by the local conservation district in order to remain eligible for USDA program benefits.

Swampbuster applies if you convert naturally occurring wetlands to cropland after December 23, 1985. With some exceptions, to remain eligible for certain USDA farm program benefits, you must discontinue production of annually tilled crops on newly converted wetlands.

USDA Programs Affected by these conservation provisions are: Price and income supports, crop insurance, Farmers Home Administration loans, Commodity Credit Corporation storage payments, farm storage facility loans, Conservation Reserve program annual payments, and other programs under which USDA makes commodity-related payments.

Local Soil Conservation Service personnel can predict your farm's soil loss resulting from several crop and conservation practice alternatives. They also help you lay out contour lines, if needed, or provide engineering design for ponds, terraces, etc. It is, generally, best if both landlord and tenant are involved when NRCS personnel are invited to size up the farm's problems and potential. This can also provide an opportunity to evaluate problem areas on the farm, discuss past farming practices, and

consider changes which need to be made.

It is important that each party recognize that some of the farm's conservation needs may involve significant changes on their part. These may involve changes in tillage methods, timing and practices on the part of the operator and land improvement expenditures for tiling, terraces, waterways, etc. for the landlord. Changes in tillage often necessitate purchases of equipment designed for conservation tillage. Improvements can, often, be made over time to protect the profit potentials of both parties.

Erosion control measures can be incorporated into a lease contract. However, any control measures should be thoroughly discussed and agreed on by tenant and landowner.

Guidelines in the lease might include no fall tillage or soybean stubble, contouring on slopes greater than __%, tillage practices to keep __% of the crop residue on the surface at planting time, etc.

Implementation of solid conservation practices may change the economics of crop production due to changes in the costs to be borne by each party. Therefore, lease provisions may be altered to account for the changing cost structure.

CORN SUITABILITY RATING (CSR)

Crop yields for a given soil type vary from year to year and increase over time with the adoption of new technologies. This makes potential crop yield a poor indicator for comparing soils. The Corn Suitability Rating (CSR) is an index procedure developed in Iowa to rate each different kind of soil for its potential row-crop productivity. The CSR assumes: (a) adequate management, (b) natural weather conditions (no irrigation), (c) artificial drainage where required, (d) no frequent flooding, and (e) no land leveling or terracing.

CSRs are expected to remain relatively constant in relation to one another. Ratings range from 100 for soils that have no physical limitations to as low as 5 for soils with severe limitations for row crops. Information on the CSR and potential crop yields for each soil type are included in or along with each county's published soil survey report.

Yield estimates for soil types are generally based on a high level of management and normalized for a 5- or 10-year average.

CSRs are specified for average management and assume that new technologies will be relatively applicable to all soils. Because of rapidly changing production practices and the adoption of new technologies, potential crop yields are usually outdated as soon as they are published. Both crop yields and CSRs will decline with increasing physical limitations, such as steepness of slope and degree of erosion. For example, the CSR for a Tama soil ranges from 68 to 100, and the corresponding potential corn yield ranges from 149 to 170 bu/A, depending on the slope of the soil and degree of erosion. For more information on Corn Suitability Ratings, see "Corn Suitability Ratings – An Index to Soil Productivity" (Pm-1168).

BUILDING AND MACHINERY RENT

Rental agreements for farm buildings and facilities and for farm machinery are important in some situations. Those with an interest in leasing terms and agreements for these items may wish to obtain a copy of "Rental Agreements for Farm Machinery, Equipment and Buildings," NCR 214, and "Farm Building Rental", FM-1798, from your County Extension Office. In addition, a Farm Building Rental survey is available.