

Lease Arrangement Considerations

Under a crop-share lease, both the landowner and the farm operator share in yield and price risks. The farm operator (tenant) contributes labor and capital in the form of machinery. The landowner contributes the land. Both parties pay a share of input costs (seed, fertilizer, chemicals) and share the harvested crop. The percentage share of input expenses is in general equal to the share of the harvested crop. Responsibility for payment of various expense items and at what percentage is negotiable.

In theory, as the owner is taking on greater risks (production and price), than in a cash rent arrangement, the landowner should be able to achieve a greater overall rate of return on the land investment as opposed to cash rent. Cash rent, while diminishing risk to the landowner, also frequently pays a higher rate of return on the land investment. The 2001 Farm Lease Survey suggests that producers are bidding up cash rent beyond what may be feasible for long-term sustainability for the producer. Increasingly higher cash rent transfers more risk from the landowner to farm operator.

Here are several items to consider before switching to cash rent:

1. Do Your Homework

A cash rent arrangement can be just as long-lived as a crop-share arrangement. Be careful of coffee shop talk. Higher cash rent levels should in theory diminish the pool of operators willing to pay higher levels. If the cash rent level is higher, the current tenant may be unwilling to continue the relationship. Ask yourself the following questions. What are the historical levels of net income generated from this farm and how much does that income fluctuate? How much are the property taxes, insurance and repairs on the farm? There are several sources where you can get an idea of what is being charged for cash rent in your area, including University of Illinois Extension at: www.farmdoc.uiuc.edu/management

2. Material Participation

Participating in the management of the farm may be beneficial for Social Security and/or Estate Planning. If the landowner needs credits for Social Security payments, it may be beneficial to maintain the crop-share arrangement. Also, if the landowner has sizable assets to pass on to heirs upon the death of the landowner, there are estate-planning tools that may be applicable to shrink the size of any taxes that may be otherwise due.

Contact your estate planning professional for more information before changing your lease arrangement. Switching from crop-share to cash rent may change your ability to participate materially, thus potentially having an adverse effect.

3. I Want to be Involved in the Operation

Under a crop-share agreement, the landowner typically is more involved in the day-to-day operations of the farm than with a cash rent arrangement. During the recent sign-up period for the 2002 Farm Bill, many landowners utilizing cash rent arrangements had difficulty documenting base farm yields for the FSA, as the owners had not been actively involved.

Fertilizer, tillage, and cropping decisions may also be something the landowner wants to be involved in. In reality, a good written lease agreement can achieve most goals concerning production records or management decisions. Crop-share agreements naturally render themselves to more joint decisions between the landowner and farm operator.

Some landowners simply want to be involved in farm management. They enjoy making decisions, and marketing commodities.

4. I Want to be Fair

First, assess how much you need to have the income generated by the farm. What happens to your needs if there is a production failure? Crop insurance takes care of most of this, but comes with a cost. If you need the money to provide the basic necessities for yourself or your family, this should impact your decision. If your needs are being met, then look at the needs of the tenant, if that is your goal. Over the last ten years in Illinois, cash rent bids in Illinois have at times exceeded what is practical for farmers to make a profit for farming rented ground. This represents a philosophical as well as a business dilemma. Is it the responsibility of the landowner or the farm operator to hold cash rent to sound profitable levels for the producer?

Here is a checklist to think about before changing the way you lease your farm

-Are there financial, legal, or personal reasons to keep my crop-share arrangement?

-Do I have the time (or want to take the time) to actively be involved in the management of the farm? Switching to cash rent will probably diminish my involvement in farm management and provide me with more spare time.

-Do I need (or want) a predictable return to my land investment that cash rent would provide?

-Keep in mind, that regardless of whether I lease my ground through cash rent or a crop-share agreement, I need to be involved enough to protect my investment. I can pay someone else to represent my interests (farm manager), or do it myself.

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