

William R. Harryman
Extension Educator, Retired
Farm Business Management and Marketing

Some farm owners have switched from the traditional crop-share lease to a cash lease. Instead of receiving a share of the crop, they are paid cash.

Reasons for switching from a crop-share lease to a cash lease may include a desire for less involvement in the farm operation on the part of the owner and simplified farm record keeping for the operator. Cash leases are one of several options that owners and operators should examine before judging which lease form is best.

The Cash Lease

Under a cash lease, the owner gives management responsibilities and use of the farm to the farm operator in exchange for an agreed amount of cash. This cash payment is the rent.

Under a typical cash lease, the operator will receive all crop income, make all management decisions and pay all crop expenses. The owner will pay land taxes, his/her own insurance and major building repairs.

For this, the owner receives a known, stable income and is freed from farm management responsibilities. Under a cash lease, government payments are usually paid in full to the operator. The owner is deemed to not be farming as he/she is not at risk for yield or price. The responsibility of reporting crops each year falls to the operator. Some owners, however, have negotiated different government payment arrangements with their operators. Typically, the Internal Revenue Service calls this passive or non-earned income, affecting eligibility for Social Security.

A primary concern of owners is that unscrupulous cash-rent operators may abuse or mismanage the property. Mining soil fertility (removing nutrients without replacing them), allowing weeds get out of

hand, or abusing buildings are among some of the owner concerns. In reality, these abuses seem to be rare and can usually be dealt with in the cash lease agreement.

Soil fertility tests taken at the beginning of a cash lease and then taken periodically (every 3 or 4 years) can help assure owners that their fields are not being "mined." Who pays for the soil testing is negotiable. In fields where soil fertility levels are below established standards, a build-up fertility program can be started. Who pays for build-up fertilizer is also negotiable. With a new operator, it is logical that the landowner restore soil fertility. With an existing operator, it is logical that he/she restore soil fertility, as he/she (presumably) depleted it.

A tenancy period of several years, removes any advantage for the operator to "mine" the land. Owners may insert a clause in the lease, stating that the renter will be reimbursed for fertilizer applied, but not consumed by the crop. This guarantee would give the renter full motivation to maintain a high fertility program throughout the lease term.

Periods of rapid inflation and farm economic variability can cause chronic rent adjustment problems in longer term leases. "Disaster-bonus" clauses or flexibility clauses can be built into the lease to protect both owner and operator. Such clauses adjust the base rent up or down depending on the actual production and/or price realized during the year. Some farm owners or managers deal with this variability by writing one year leases.

A cash lease can be useful for owners with limited farming experience, for absentee landowners, or for family members who wish to lease land to a family corporation.

Cash Lease Considerations

Advantages of a Cash Lease to the Owner:

- The return on investment is usually higher than with a crop-share lease.
- The owner receives a definite, income, protecting him or her from low yields and low prices.
- The owner gains freedom from the burden of management.
- The owner can change participation levels for Social Security and other income tax reasons.
- There is less chance for controversy than with other lease types.
- The rent adjustment is easier.

Disadvantages to the Owner:

- Operators may tend to exploit the property.
- A cash lease guarantees the owner's income, limiting the chance to benefit from high yields or high prices.
- The owner may receive a smaller share of the profits because less risk is assumed.
- Under continued inflation, rents must be renegotiated periodically or some rent adjustment procedure adopted.
- The owner has no opportunity to participate materially in the farm business (may also be an advantage).
- There may be a need for crop liens for legal protection to insure rent payment.

Advantages to the Operator:

- The operator gains independence in the operation of the property.
- Successful operators under cash leases receive full benefit of superior management.
- Cash leases **may** give an operator a larger share of profits.

Disadvantages to the Operator

- It may be difficult to get the owner to provide improvements needed.
- The rent does not automatically adjust to changes in prices and production unless some advance provision is made in the lease.
- Operators with limited capital or credit bear a

heavy risk (100%) in years of poor crops or low prices. A disaster clause in the lease can allow some relief of this risk.

- It is easy to bid too-much rent to farm profitably. A cash-lease can destroy the cash flow.

Payment Schedule

The date of rent payments will also influence the true cost of the rent. There is no standard cash payment date. Payments range from 100 percent "up front" (March 1) to 100 percent paid after harvest. Many leases call for two or three payments per year; a portion on March 1, more as the crop is harvested and the balance after the first of the year. Rents demanded at the beginning of the lease year should be a bit lower than those paid after harvest as the landowner will net additional income on "up-front" rental payments in the form of interest earned on that money. Also, the operator may be paying additional interest on this borrowed money used for the rent payment and thus incur higher total costs.

About one-half of landowners surveyed in 1995 paid no limestone expense under cash leases, meaning that cash-lease operators paid for all the limestone applied (if any). Nearly 30 percent of landowners still pay for all the limestone. This way, they do know that the lime requirements are being met.

Additional Thoughts

Choose cash rent operators carefully. They should be financially sound and control adequate farming equipment to get their work done in a timely fashion. Farming is a business and as such, some farmers take their business more seriously than others. Look for good character and someone with whom you can communicate.

When negotiating cash rents, it is important to remember that the value of a renter or operator of known quality may be more important than a "full price" or "top-dollar" rental bid from an operator who can't deliver on the agreement.

