Getting Started with Farm Leases in Marin County

Background

Most Marin County beef, sheep, and dairy producers rely on leased land for at least a portion of their operations. The recent resurgence in row crop farming in Marin has resulted in leases for use of small portions of ranches by fruit and vegetable farmers, providing farmland for new farmers and a diversified source of ranch income for ranch landlords.

A lease is a legal document, which can be oral or written, and grants a right to a tenant or lessee to use property belonging to the landlord or lessor. The relationship between the landlord and tenant is called a tenancy, and the tenant's right to use the land is sometimes called a leasehold interest.

As one local farmer said "a handshake is probably not the best way to go about it" in reference to setting up a lease. "It's better to have something in writing because people have different memories about what was agreed to,"

For row crop farmers, having a written lease with an agreed-upon lease term is preferable in cases where farmers plan to invest in infrastructure or need to obtain bank loans.

Types of Leases

There are two main types of leases: cash rent and crop-share. The major differences between these two types is how risk is shared between the landlord and the tenant. Other types of leases include livestock-share (structured similarly to crop-share), labor-share, and flexible-rent leases.

Cash Rents. Cash rent is the most common type of lease used in Marin County. The tenant pays a fixed payment for the use of land, and/or buildings, and other facilities. The payment is for a specified time period (per month or year) and is set prior to the tenant using the land. With cash rent leases the tenant receives all income and the financial risk lies mostly on the tenant. The only risk the landlord takes is the tenant not being able to pay the rent. Because it is a fairly stable income, the landlord should expect cash rent to be lower than the expected return from a share rent agreement. The tenant has all the uncertainty of production and prices; he/she will receive all profits in a good year and all losses in a bad year.

A cash rent agreement should include the amount and terms of payment, the time period, and any restrictions that the landlord may place on the use of the land, buildings, or facilities. For land, the time period is usually one year, although an agreement may be multi-year with or without provision to reassess the payment each year. The landlord may include restrictions on the maintenance of facilities. Otherwise, the tenant is free to make all operating decisions; the landlord usually does not have any management input.

The advantages of a cash rent lease are:

- It is simple.
- The landlord is assured of a steady income.
- The landlord does not have to help manage.
- The tenant has freedom to manage--within the restrictions of the agreement.

The disadvantages of a cash rent lease are:

- The landlord does not share in very profitable years.

- A landlord may rent to a tenant who exploits the land and improvements, unless restrictions are written into the lease.
- It is riskier for the tenant; the payment is fixed before production and income is known.
- A tenant may find the landlord slow or reluctant to maintain buildings and facilities unless provisions for maintenance are written into the lease.

One difficulty with a cash rent lease is determining a fair price.

Crop-share. With a crop-share lease, the landlord and tenant agree to share the income from the land, but they do not set a specific amount of money. The landlord receives a share of the gross income to compensate for his/her costs. Usually a crop-share lease calls for shares in gross income equal to shares in total expenses; however, local rates, profit variance, and other factors may have a large impact on the agreed shares.

By receiving a share of income rather than a fixed payment, the landlord takes on more risk than with cash rent. Thus, he/she may seek a higher expected return with a crop-share lease than with a cash rent agreement. Since the tenant shares income risk, he/she does not require an expected return as high as with a cash rent.

When leasing a whole farm, a landlord and a tenant may agree to a crop-share lease on the cropland and cash rent on the buildings and facilities. Or, they may set the crop-share lease with the knowledge that the buildings and facilities are included.

The advantages of a crop-share lease are:

- The uncertainty of production and prices are shared by landlord and tenant.
- Both parties share in increased income due to new technology and management (e.g., irrigation management, pest scouting).
- The capital requirements of the tenant are reduced so his/her financial risk is also reduced.
- A knowledgeable landlord may improve income by participating in operating decisions.
- The landlord has more control over the use of his/her land and other assets.

The disadvantages of a crop-share lease are:

- The tenant is not totally free to make operating decisions.
- The tenant has to share during good years as well as bad.
- If the landlord is not knowledgeable, he/she may lead to unwise operating decisions and decrease income.
- The landlord may receive a lower return than he/she would have for cash rent in poor income years.

There are difficulties with a crop-share lease. (These are true for all share-rent leases.) The first difficulty is deciding on the equitable share of income. Other issues that might arise include: Who makes the final decisions when there are disagreements between landlord and tenant? How is an equitable payment determined for forage when it is fed to livestock on the farm or ranch? How much should be charged for residences and other buildings used by the tenant? Who should pay for maintenance? Many of these difficulties have to be settled personally between landlord and tenant. Then, a fairly standard process can be used to determine shares.

Determining Lease Rates

Lease rates can be set by mutual agreement of the landlord and tenant, and should consider land attributes such as soil quality, proximity to markets, water supply, and existing facilities to be used by the tenant. If the tenant must make permanent property improvement to use the land, the cost, their expected life, their residual value to the landlord, and other factors should be considered in determining who bears the costs of improvements.

A Leasing Checklist

Any time two or more parties join together in a business arrangement, dissatisfaction or disagreement is possible. Some problems can be avoided by planning ahead. Key points to consider in leasing arrangements are:

- Make sure there is economic gain for both landlord and tenant. Without a profit, somebody will be unhappy and the arrangement will likely fall apart.
- Put the lease in writing! In case of a dispute, a written lease prevents many legal problems by forcing all parties to consider explicitly the terms they are agreeing to.
- Make sure the lease provides for legal protection for both parties. Neither landlord nor tenant wants the agreement construed as a partnership.
- Make sure all parties have agreed on the contribution each is to make to the leasing arrangement.
- Keep accurate and complete records and have all parties agree on who should keep them.
- Decide which party has responsibility for which jobs or enterprises and specify these in the lease.
- Agree on the responsibility for maintaining buildings, facilities, and soil fertility.
- Decide when a settlement of business earnings or rent will be made.
- Decide how the tenant is to be compensated for improvements if he/she breaks the lease before the asset is depreciated out.
- If desired, decide when and how the lease can be automatically renewed and how the rent can be renegotiated or recalculated.
- Agreements about water use should be clarified in the lease. If the landlord has a dairy or other agricultural operation that requires significant water use, the lease should specify the tenant's rights for water use.

Resources

Other sources of information include:

1. Redwood Empire Small Business Development Center (RESBDC). Affiliated with Santa Rosa Junior College, the RESBDC provides management and technical assistance for existing and potential small businesses, including one-on-one professional business counseling, workshops and seminars, and special programs designed for business owners in Marin, Sonoma, and Mendocino counties. (707) 524-1770 or 1 (888) 346-7232, *sbdc@santarosa.edu* and *http://www.santarosa.edu/instruction/jtwd/sbdc/*.
2. University of California Small Farm Center. The Small Farm Center provide a wide range of helpful information on farming at *http://www.sfc.ucdavis.edu/default.asp*

(Portions of this text were Adapted from Family Farm Series Publications: Farm Management; Farm Leases and Rents by Kent D. Olson, Economist, Cooperative Extension, UC Davis; revised by Christie Wyman, Small Farm Center, Cooperative Extension, UC Davis.)

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More information about diversifying your operation is available at the Grown in Marin website under Resources for Farmers, at http://www.growninmarin.org, or by calling the UCCE Farm Advisor's Office at 415/499-4204.