

Cropland Leasing Principles & Legal Issues in Kansas

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Crop Share Lease *Principles*

- ① Variable Expenses that are *Yield-Increasing* should be shared in the *same proportion* as the crop share
 - Encourages **both parties** to use the amount of the input that **maximizes net returns** for the operation
 - Otherwise, Tenant **doesn't have as much incentive** to apply optimal amounts

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Crop Share Lease *Expenses* *To Share or Not to Share?*

- Yield **Increasing** Crop Inputs
 - ⇒ Shared between landowner & tenant
- True **Substitution** Crop Inputs
 - ⇒ Paid for by party responsible for item in original lease
- If a Crop Input is **Both** Yield Increasing **and** a Substitute for another crop input
 - ⇒ Reexamine the lease share arrangement

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Crop Share Lease *Principles* *(continued)*

- ② All Crops Shared Alike
- ③ Both parties should share in total returns in the *same proportion* as they *contribute resources*
 - Landowners: Contribute **land**, maybe **management** & a share of **crop inputs**
 - Tenants: Contribute **labor**, **machinery**, **management**, other **crop inputs**

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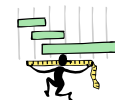
Crop Share Lease *Principles* (more)

- ④ When *new technologies / crops* are adopted, leases may need adjustment
 - More Intensive Crop RotationsTo **Wheat-Corn/Milo-Fallow** From **Wheat-Fallow**
 - ✓ More reliance on Herbicides & less on Tillage for weed control & moisture conservation - **New GMO Seed/Herbicide**
- * * * Inflexible 1/3-2/3 Share Lease Arrangements are a problem for Tenants, leading to cash rent leases

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Intensive Rotation's Effect On Equitable Lease Shares

- Alternative Crop Share Lease Terms May be Needed for More Intensive Crop Rotations
- Crop Share Leases Vs Crop Rotations
 - **More inputs shared in intensive rotations to maintain equitable contributions**
 - W-F (fertilizer)
 - W-S-F (fertilizer + herbicide)
 - W-Cn-Sb-F *or* W-Cn-Sb *or* W-W



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Crop Share Lease *Principles* (more)

- ⑤ Tenants should be *compensated* at lease termination for the *unexhausted portion* of *long term investments*
 - Terraces, Fences, etc.
 - Irrigation investments
 - Building Improvements
- ⑥ **Ongoing Communication** is needed between Tenants & Landowners

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Crop Share *Advantages*

- Risks & Rewards are shared
- **Management *MAY* be shared**
- Less operating capital "tied up" for Tenant
- **Tax management timing opportunities with crop sales & input purchases**
- Landowners may prove material participation (vs cash rental) / Social Security implications

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Crop Share *Disadvantages*

- Variable Landowner income
- More record keeping required by Tenants
- Marketing decisions required of Landowners
- Joint management decisions may need to be made by Landowners & Tenants
- Need to keep reviewing lease arrangements for equity

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Cash Rent *Advantages*

- Tenants Don't Divide Up Production or Costs
- For Landowners:
 - + Fewer farm decisions
 - + *No price or yield risk* **
 - + No crop marketing decisions
 - + *No material participation (SS)*
- For Tenants:
 - + More control of decisions
 - + *More income for best farmers*
 - + Benefits of windfall profits

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Cash Rent *Disadvantages*

- Cash Rents may be harder to Renegotiate
- For Landowners:
 - No "good year" windfall profits
 - *Few income tax management opportunities (timing of sales and/or expenses)*
 - Risk of Tenants "mining" land
 - *Harder to establish Social Security base*
- For Tenants:
 - Have all yield and price risk
 - *Higher expenses/lending needs*

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How to Determine Cash Rental Rates

- Landowner's Desired % Return
 - Landowner's Net Share Rent
 - *Equivalent Crop Share Returns*
 - What Tenant Can Afford to Pay
 - *Revenue - Nonland Costs = Affordable Cash Rent*
 - Cash Rent Market
 - *Local competitive rental rates*
 - Landowner's Costs
 - *Depreciation, Interest, Repairs, Taxes, Insurance*
- ⇒ Enter into Negotiations!!

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Final Thoughts: Crop Share Vs. Cash Rent Leases

- Crop Share Leases provide *more risk & higher potential returns* to Landlords than Cash Rent
- Landlord's Income from **Crop Shares** should be greater than from **Cash Rent** (& vice verse)
 - Riskier assets require higher returns

■ Example: CDs versus Mutual Funds



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Crop Lease Profits ⇔ Losses??

- Profit Over Non-Land Production Costs?
 - Direct Costs of Production
 - Seed, Fertilizer, Herbicide, Insecticide, Drying, Op. Interest
 - Machinery Costs
 - Repairs, Depreciation, Interest, Insurance
 - Labor & Management
- If Tenants Do Not Cover All Costs...
 - Machinery, Labor, or Management Usually **Not Paid**
 - **Result:** "Mining" of Machinery Line, Off-farm moves

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"Test of a Good Lease"

- Is it written?
- Is the crop shared in the same % as resource contributions?
- Does it encourage proper amounts of yield increasing expenses?
- Does the Tenant have potential for a profits?
- Does it promote conservation?
- Does it plan for needed improvements?
- An understanding of lease duration/conditions?

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Kansas Lease Law

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Kansas Farm Lease Law

- Terms of a Lease & Termination Notices
- Unpaid Rent & Crop Ownership
- Noxious Weed Control
- Compensation for Improvements
- Tenant-Landowner Legal Liabilities
- Death of Landowner or Tenant
- Pasture Leases



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Terms of a Lease

- Oral Leases not enforceable for more than 1 Year
 - *Written Leases terminate as specified in lease*
- Leases are Subject to Landowner's Title
 - If landowners have a *life estate*, or *interest for life* in a property, they can not give a tenant the right to lease a property for longer than they are alive

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Terms of a Lease (more)

- A "Tenant at Will"
 - Tenants who hold possession of premises by owner's permission, **BUT** without a fixed length of time on lease
 - Tenant holds land **UNTIL** given a termination notice
 - Implications if Landlord Dies???



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Lease Termination Notices

- In writing (*Registered Mail is preferred*)
- At least **30 days prior to March 1st**
- Spring planted crops:
 - Must fix tenancy termination date on **March 1**
- Fall seeded crops (Continued)



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Lease Termination Notices (more)

■ Fall seeded crops

- Will be terminated the day after harvest or on August 1st
 - Notice must fix termination on March 1st, but tenant has the right to the existing crop
- *Recent Legal Ruling (2000):* If notice is given early, **BEFORE** field work starts to seed the wheat crop in the fall, then lease is terminated on following March 1



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Lease Termination: Example #1

- Written termination notice delivered to Tenant on **February 1, 2008**, fixing termination of the lease on **March 1, 2008**. No fall seeded crops are present on the leased ground
- Issue: Not a Timely Termination Notice
 - **Not an adequate termination notice..not given at least 30 days before March 1, 2008**
 - Lease renews for another year. Timely notice to terminate is required

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Lease Termination: Example #2

- Written termination notice delivered to the Tenant on **January 15, 2008**, fixing termination of the lease on **the last day of wheat harvest, 2008**. Fall seeded crops **ARE** present on leased ground
- **Issue: Inappropriate Termination Date**
 - Lease Termination date needs to be March 1, even if fall seeded crops are present
 - However, if **August 1** was selected as termination date, that is effective notice & lease terminates (Mendenhall vs Roberts)



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Lease Termination: Example #3

- Written termination notice delivered to tenant on **January 15, 2008**, fixing **March 1, 2008** lease termination date. Fall seeded crops present on 1/2 of leased land, Milo planned on other 1/2
- **Issue: Proper Notice, Differing End Dates**
 - **For the seeded wheat, termination either after harvest or August 1, 2008 (whichever is first)**
 - **For other nonseeded land intended for summer crops, regular lease termination on March 1, 2008**

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Other Termination Issues

- Written Lease Agreements
 - **Written lease termination notice terms** will supercede state law for oral leases
- Tenants Continuing On Expired Lease
 - **Situation:** Tenant continues leasing land on a yearly basis **AFTER** original written lease expires
 - Notice of termination must take place as was agreed upon **in the original written lease, NOT** according to Kansas lease law
 - Still require **30 days notice** prior to termination date

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Compensation for Crop Inputs

- Compensating Tenants for Used Crop Inputs
 - **IF** prior to termination notice, Tenant has tilled, applied or furnished fertilizers, herbicides, or pest control substances & has **NOT** planted the crop...
 - **THEN** the Landowner must pay the tenant a fair and reasonable value of those services furnished
- For Alfalfa (multiple year crop)
 - When a stand is established **the Previous Fall** & proper termination notice has been given, Tenant must be paid for seed bed preparation & seeding



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Compensation for Improvements

- Tenants Are **NOT** Allowed Compensation for Land Improvements **UNLESS** Otherwise Stated in a **Written Lease**
 - Permanent improvements on leased property made by Tenant can NOT be removed when lease is terminated
 - **Buildings, Terraces, Improvements, Irrig. Systems**
 - **Exception:** 2001 Kansas Case (Removable Barn – Personal Property of Tenant)
 - Tenant can remove structure if had a) prior agreement, b) tenant pays taxes, c) separate utilities, d) structure not permanently affixed, etc.



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Unpaid Rent & Crop Ownership

- **Unpaid Rent is an Automatic Lien on Crops**
 - With a cropshare lease, a **RENTAL LEIN** attaches to the landowner's share of the crop
 - The landowner must file to perfect this lien
 - **In Kansas, a cash rent Landowner does NOT get priority over a second party**
 - The Landowner needs a security agreement and financial statement if the crop is collateral
 - The Landowner's lien can be avoided in the event of a Tenant's bankruptcy



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Noxious Weed Control



■ Whose Control Responsibility Are They?

- BOTH Landowner & Tenant are responsible during the term of the lease, since the tenant usually has exclusive supervision of the land
- **Key Issue:**
 - IF noxious weeds are **NOT properly controlled**, the county has authority to apply treatment & charge the **Landowner** (not the Tenant)
 - IF not paid in 30 days, the treatment cost becomes a lien against the land

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Tenant-Landowner Liabilities

- Traditionally, the **Tenant** is Legally Liable for **Personal Injuries** on Leased Property
 - The Tenant has possession of the land & the responsibility to maintain the premises in a **reasonably safe condition** to protect persons who come upon the land
- Exceptions (*continued*)



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Tenant Liability Exceptions

When Landowners May be Liable

- Existence of Undisclosed Dangers (*"hidden" wells*)
- Danger to others Off Premises (*low hanging tree branches over a public road*)
- Negligent Repair by the Landowner
 - Or, **Express Covenant** by the Landowner to repair property & **failure** to do so
- Premises leased for Public Admission (*leased for dispersal sale*)
- Part of leased property is in Landowner's control which Tenant may use



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Death of Landowner or Tenant

- If Either Party Dies while lease in effect,
 - If Tenant Dies, **the lease is terminated** – no notice to the tenant's heirs is necessary
 - If Landowner Dies, heirs assume the lease
- If Landowner has Life Estate in the Property
 - A lease can only be granted by that Landowner for as long as they are alive
 - Any lease of land held in a **Life Estate** terminates at the death of the life estate holder
 - **Estate** of the life estate holder receives LO's crop share

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Death of Landowner (more)

- If the Landowner owns less than a “fee” or full interest, other legal issues may arise..
 - Are a Landlord’s heirs entitled to the Landlord’s share of a crop under a crop-share lease?
 - OR do the Tenants who hold the “remainder interest” take the entire Landlord’s Share?
 - (Kansas) Landlord’s crop-share is personal property of decedent’s gross estate at death
 - Distribution governed by decedent’s will or by state law if no will exists

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Pasture Leases

- March 1st Lease Termination DOES NOW Apply to Kansas Pasture Leases (2002 Law)
 - Written Pasture Leases to spell out rights & responsibilities of both parties
 - Care of fences
 - Noxious weed control
 - Water supply maintenance
 - Grazing capacity restrictions
 - Termination notices & Rental or share arrangements



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Valuing Tenant Management

- A bargaining proposition
- Depends on
 - a) Who manages the farm
 - b) The value of good farmland management
- Potential valuation guides
 - 1.5% to 2.5% of capital managed
 - 7% to 10% of gross receipts
 - Emphasis on the “long term”



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Pasture Rent Information

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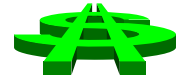
Recent Pasture Rent Surveys

- Kansas Ag Statistics Survey (2002)
- Pasture Leasing Surveys in Rooks and Smith Counties (2002)
- Pasture Rental Arrangements in Western North Central Kansas (1999)
 - Trego, Rooks, Russell, Osborne, Phillips, Smith Co.

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Pasture Rental Arrangements in Western North Central KS (1999)

- Number of Surveys: 116
- Pasture Rent
 - \$11.02 /acre (Average)
 - Range: \$6.75 to \$20 /acre
- Type of Pastureland
 - 79% Upland
 - 9% Lowland-River Bottom
 - 12% Combination Upland & Lowland



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Rental Period, Stocking Rates & Cow Weights (1999 West-NC KS Survey)

- Beginning Rental Date
 - April 27 (Ave.) (Range = March 1 to June 15)
- Number of Months Rented
 - 6.4 months (Ave.) (Range = 4^{1/2} to 12 mo.)
- Stocking Rate per Acre
 - 8.1 acres/head (Ave.) (Range = 4 - 12 ac/hd)
- Average Cow Weight
 - 1160#/cow (Ave.) (Range = 950 - 1500# /cow)



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Livestock Water Supplies

West-North Central Kansas Survey (1999)

- **3% Transported Water to Pasture**
- Pond: 70%
- Stream: 32%
- Well: 51%
- Responsibility for Livestock Water
 - 72%: **Tenant's** Responsibility
 - 31%: **Landowner's** Responsibility

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Weed Control

West-North Central Kansas Survey (1999)

- **Weed Control Responsibilities**
 - 82% Tenant
 - 33% Landowner
 - 15% Both Landowner & Tenant
- **Special Weed Control Arrangements**
 - 37% of Survey Arrangements

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Grazing Rate & Water Source Effects (1999 West-NC KS Survey)

- **Grazing Rate Effects**
 - For each **1 acre/head Increase** in Stocking Rates, Pasture Rents **Declined by \$0.30 /ac.**
Poorer pasture with higher grazing acreage requirements is worth less in terms of \$/acre
- **Water Source Effects**
 - Having a **POND** leads to a **\$1.38 /ac. Increase** in pasture rent /ac.
*Having to **TRANSPORT** water has a **negative** but not significant impact on pasture rents*

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Watering & Fencing Effects

West-North Central Kansas Survey (1999)

- Landowner Watering Responsibility Effects
 - If a **Landowner** is responsible for **watering livestock**, pasture rates tend to be **\$1.12 /ac. Higher**
- Landowner's Provision of Fencing Materials
 - If a **Landowner** is responsible for **providing fencing materials**, pasture rates tend to be **\$1.12 /ac. Higher**

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Comments or Questions?

- Email: dobrien@ksu.edu
- KSU Ag Economics Website:
 - <http://www.agmanager.info>
- Northwest Research Extension Center:
 - <http://www.oznet.ksu.edu/nwao/>

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