Ethics of Renting Agricultural Land

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We each have spent years working with landlords and tenants in developing rental arrangements. In the process, we always attempt to improve landlord and tenant understanding of the economics of renting land. And, we ourselves learn from that process every day. We have had the opportunity to see situations where the landlord-tenant relationship was extremely strong, and unfortunately, we have been involved in a number of situations where the relationship was "less strong." As economists, we have a distinct preference for "working with numbers." Yet, we regularly spend as much or more time assisting with the psychology, emotion, and ethics associated with land rental arrangements. Intrinsically, the field of ethics is much more subjective than objective. So, in discussing such a topic, we risk drawing fire from our own profession as well as from the business world. Yet, since we deal with this area so much, we believe that noting a few of our observations could be worthwhile to landlords and tenants. We admit that there is, and always will be, gray areas between the black and white, and that our perceptions have evolved and will continue to evolve over time. So, we welcome the reactions of both landlords and tenants to our thoughts presented here.

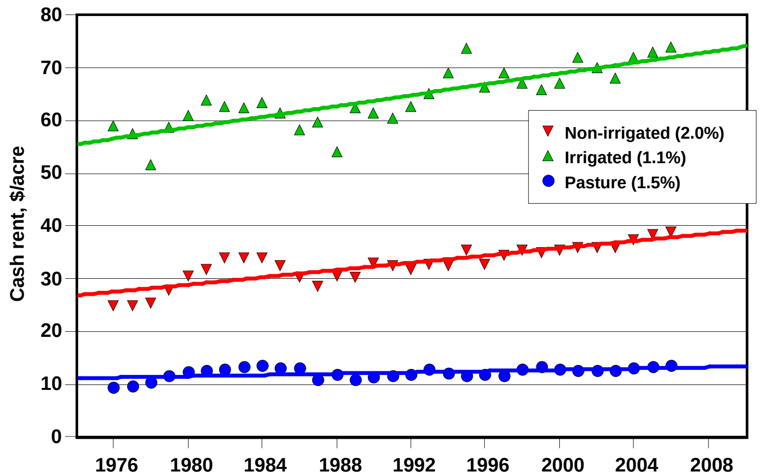
Cash rent drives rental arrangements
Generally, land rental arrangements can be characterized as either cash or share arrangements. With a cash arrangement, the tenant pays an annual fee to the landlord and in turn gets 100 percent of the crop and government payments. With a share arrangement, both the landlord and tenant share in the costs and in the income. Equitable share rental arrangements are based on the idea that crop and other related income is split between the landlord and tenant in the same percentage as annual cost contributions. An important annual cost contribution of the landlord is his or her opportunity cost. More and more today, this opportunity cost is best characterized as the going cash rent in the area. So, regardless of whether the rental arrangement is a cash or share lease, a market cash rent value generally underlies it. So, we begin with the premise that a $/acre market cash rent can be known in an area. Those wanting assistance on knowing the cash rent value should contact their local Extension Office or turn to the web to uncover related publications in their states. For example, www.agmanager.info provides a number of such publications, particularly for Kansas.

Tenants have the most informational power
We regularly observe that landlords a) reside far away from where their land is located, b) are out of touch with current farming practices since they either have been gone from the farm for decades or otherwise obtained the land through inheritance or marriage, and c) often are elderly people. Meanwhile, tenants generally are intimately aware of market rents and land values, and typically recognize the possibilities and limitations of current farming practices. So, tenants usually have much more relevant information than landlords. With that informational power comes a responsibility to *not* take advantage of the landlord. This does not mean that landlords cannot make special concessions for their tenants. But, such concessions should be made with full knowledge that they are concessions. For example, we routinely see landlords that make

concessions and both parties get along very well. However, it is when tenants start to view these concessions as entitlements that problems begin to surface.

Though $/acre rents do both rise and fall with time, their trend generally has been upwards. Figure 1 shows the average cash rents, as reported by Kansas Agricultural Statistics, for irrigated, non-irrigated, and pasture land in Kansas. Also shown is the upward trend and the average annual year-to-year percentage change from 1976 through 2006 for each class of land. Even though cash rents have been steadily increasing over time, we routinely get calls from landlords or heirs of landlords that reveal that their rental rates have not changed for years, and sometimes decades. The landlord's response typically is "we didn't know." The tenant's response typically is "the landlord never asks for more rent," or perhaps, "but, I do a lot to keep up the land and so do not consider the arrangement to be unfair." We believe that such situations are more often the fault of the tenant than the landlord – since the tenant holds the informational power and should have the responsibility to keep the landlord informed. Consequently, our advice to such landlords often is "Get a different tenant. If he didn't keep you informed before, why would you think he will in the future?" While we recognize that landowners have a responsibility to know what the value of their assets is (i.e., what current rents are), we believe that tenants should help make this information readily available.

Figure 1. Average Cash Rents in Kansas



Source: Kansas Agricultural Statistics

What about manna from heaven?

When we refer to "manna from heaven," this consists of totally unexpected money amounts that accrue to the tenant or landlord. Unfortunately, many of such payments are like manna only to some degree. A few examples of payments that can have manna-like characteristics are a) CRP (conservation reserve program) payments, b) CSP (conservation security program) payments, c) payments from utility and mineral companies for "damages." Perhaps because of the government's bias in favor of the farmer (typically, the tenant), payments like CRP and CSP seem especially prone to abuse, particularly when such payments compensate tenants for activities they would be doing anyway (for example, no-till farming), or for activities that are not even done (for example, mowing CRP), and especially when many of the associated practices (for example, grass seeding) are directly compensated anyway. The typical tenant rationalization is "but, it's my management practices that make us eligible for this payment." We encourage the landlord to reply with "but, it's my land on which you operate and you've been doing these things anyway." All in all, for a tenant, the guiding principle should be his answer to the question, What is my cost associated with this money? If the answer is "nothing," the money should be offered to the landlord. If the answer is "10% of the amount," then 90% should be offered to the landlord with that explanation. Thus, we are not suggesting that tenants do not get compensated for additional costs they might incur, but we are suggesting that returns above and beyond their costs go to the landlord. Note that the above guiding principle applies to both cash and share rental situations.

For now, we do not believe that ad hoc disaster program payments should be considered manna from heaven. That is because they have occurred historically with such regularity that they likely are already factored into market rental rates and share rental agreements.

Is paying rent way below the market unethical or just being a good businessman?
The answer to the above question depends on the motives (note that we are referring to rent that is below the market for land of the same quality; i.e., the lower rent is not due to land being lower quality). The more the tenant can answer that he strives to keep the landlord informed of current rental rates, the more it looks like he's doing the right thing. On the other hand, the more the tenant's response is "the landlord has never asked for more," the more it looks like unethical behavior.

What about tenants who offer much more than the market rental rate?
Most simply, tenants pay more than the market rent because they believe that operating more land will make them more profitable. From that premise, the answer to this question becomes more complex. Some tenants pay more because they are already profitable and recognize the potential benefits to farm growth. They expect, because of their management abilities and the economies of size in farming, that they will always be able to pay above the market rental rate as their farms grow into the future. Certainly, such tenants are considered ethically appropriate in our books. Others pay more than the market to "get their foot in the door," with little thought about whether they will actually be able to continue to pay above the market in the future. Unintentionally, and sometimes intentionally, such tenants are the ones who fail to increase rents to their landlords over time, so that paying above the market turns into paying below the market. Worse yet, some very quickly complain to the landlord that they cannot be profitable and so they negotiate for lower rents in the future. Such tenants know that landlords often are slow to change tenants and wish to take advantage of that fact. Not surprisingly, we do not consider such tenants to be ethical.

Who needs the money the worst?
A common statement we hear from tenants is "besides, she [referring to the landlord] doesn't need the money." This is not to say that landlords do not choose to aid tenants with concessions. But, such concessions should be due to the landlord's big heart and not because the tenant thinks he deserves it.

What about landlord ethics?
Because we typically experience a much higher incidence of questionable tenant behavior than bad landlord behavior, the tenant has been the focus of our attention up to here. But, landlords also behave unethically, which we describe by example. Unexplained or unsubstantiated demands should be construed as unethical. For example, a landlord might just declare that he "gets" certain manna-type payments, with no consideration of the implicit or explicit cost to the tenant. A landlord's field that becomes dotted with utility poles or oil/gas wells, or demanding

certain farming practices that enhance the landlord's hunting experience, should be accompanied by reduced rents. A landlord who has paid too much for land should not assume that his higher land price should imply a higher rent. That is, the argument about who "needs the money worse" works both ways. Landlords are especially prone to fixing problems associated with past tenants by making unnecessary demands on current tenants – without ever establishing whether current tenants have the same problems. Landlords who have not kept up with farming practices often view changes proposed by the tenant as taking advantage of the landlord. A request to help pay for lime or other inputs (e.g., herbicides, technology fees) when such inputs were not historically needed or shared is one example. A request to allow reduced or no tillage practices is another. Finally, landlords, believing the relevance of the idea that "they're not making any more land," sometimes play the trump card of asserting to the tenant that, "I can always find another tenant." Obviously, such statements are quite offensive to tenants, and just like the tenant who fails to share information with landlords, we consider this to be unethical.

Family problems often are the greatest
Because farming activities run in families, many rental arrangements involve families. So, it is natural that many problems with rental arrangements happen to involve families. But, it seems that a disproportionate number of problems we see have to do with families. Likely, this is due to several reasons. First, parent-child relationships often create expectations due to "sweat equity." That is, "son, if you put up with less income now, some day this will all be yours." Then, when the parents die, the land goes to the children and the farming heir believes he has a right to extract some of that "sweat equity" he earned earlier. Related to this, a son who receives concessions from his parents to help him get started often feels entitled to these same concessions from his siblings when they inherit land when the parents pass away. The siblings may not see it that way, which leads to family problems. A second reason is that family members generally have trouble believing that their own parents, children, or siblings would cheat them. After all, "we're all family." So, related emotional pain can be great, causing extreme disgust for the person perceived as doing the duping. Finally, we are generally stuck with our families. So, we can't really walk away from the pain of an unethical situation like we can when it involves a non-family party.

Ethical behavior is profitable in the long run
Often the result of poor ethical behavior is higher turnover of tenants. This has a cost for both the tenant and the landlord. Moreover, tenants who believe that land will shortly be taken away from them are less inclined to do the most profitable thing for the land in terms of soil fertility and soil conservation. Behaving ethically greatly reduces the costs associated with constantly "looking over each others' shoulders." Such costs typically involve increased management, accounting, and legal work. Inequitable share rental arrangements, where revenue is not shared in the same proportion as costs, lead to reduced profit for the farm as a whole, and so a smaller pie to split between the tenant and landlord.

As noted at the outset, a number of our assertions in this paper seem opposed to general profit maximizing theory. That is, economists extol the virtues of paying the least cost, receiving the highest price, or using asymmetric information to one's advantage. The apparent contradiction lies in confusing the short run with the long run, or perhaps failing to understand the interactions between the activities. That is, a tenant paying a higher rent in the short run might reduce his costs in the long run. Similarly, a landlord requesting a lower rent in the short run might end up with a higher net price in the long run.

Conclusion

We saved the previous section to the last because we believe strongly that ethical behavior should emerge because it is the right thing to do, not because it increases profits. Yes, it is true that profits increase along the way, which is great. But, focusing on ethics for profit likely will not achieve the desired goal. This is especially true from the landlord's perspective. The landlord can quickly see through behavior that looks like "I'm going to treat this landlord nice so that I get his land some day." A landlord can quickly see that such people no longer behave nicely once it is clear they are not getting the land. But, tenants can also perceive such disingenuous behavior on the part of a landlord, who might constantly "butter up" a new tenant so that he can extract favors from one tenant after another. Either way, the personal question that should always be asked and answered is, Will I treat that individual the same even if we don't have a business relationship?

Another tie-in between ethics and economics is this. Bad business leads to unethical behavior. For example, initial failure to assess costs properly often leads to an over-inflated view of what one deserves. Continued lack of cost assessment leads to rationalization of our behavior. At some point, what started as poor accounting ends up as unethical behavior. With proper financial assessment, landlords and tenants can discuss more objective things like costs of doing business, which more readily leads to acceptable rental arrangements, not just in the short run, but also in the long run. With proper financial assessment, there is no such thing as "sweat equity." So, despite starting out this paper as though economics and ethics are independent of each other, we end by closing the circle. Ethical behavior leads to good economics (profit) and good economics leads to ethical behavior.