Leasing Irrigated Farmland

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Irrigated Acres by State in 2007

Source: USDA’s Farm & Ranch Irrigation Survey
Farmland leasing in Tennessee (2007)

- 27% of Tennessee’s farmers lease land from someone else
- 34% of Tennessee farmland is leased
What is a lease?

- Both a contract and an estate in land (i.e., a property right)
  - By which a landowner transfers to a tenant the right to use and possess real property
    - For a limited period of time
    - Contingent upon payment of rent in the form of cash (cash lease) or a share of the crops or livestock produced (crop or livestock share lease) or some combination of the two (hybrid lease)
Types of Farmland Leases

- Cash Leases
  - Fixed
  - Flexible
- Crop or Livestock Share Leases
- Hybrid Leases

Cash Lease

- Fixed cash lease – rent is predetermined or fixed by the lease agreement
  - Tenant makes production and marketing decisions
  - Tenant bears all of production and price risk
- Flexible cash lease – rent is tied to yield, crop or livestock prices, and/or input costs
  - Tenant makes most production and marketing decisions
  - Landowner and tenant share production and/or price risk
Crop or Livestock Share Lease

- Rent is a specified share of the crop or livestock produced
- Landowner and tenant share
  - Expenses associated with operation
  - Production and marketing decisions
  - Production and price risk

Hybrid Leases

- Combination of any of the above
  - Example: Guaranteed bushel lease – rent is a predetermined number of bushels of the crop
- Landowner and Tenant share production and/or price risk
Additional Leasing Resources

**UT Extension Publications**

*Introduction to Farmland Leasing*

- Cash Leases
- Crop-Share Leases
- Pasture Leases
- Lease Termination

**Farmland Legacy Leasing Toolbox**


- Online decision aid to help landowners and tenants
  - Choose between types of leases and
  - Calculate “acceptable” rental rates
Average Cash Rental Rates by ASD and County (2008 – 2013)

http://economics.ag.utk.edu/crop.html

Irrigation and Farmland Leasing

• How does irrigation influence...
  – Choice of lease type?
  – Rental rate?
  – Lease term?
  – Need for additional provisions?
  – Importance of having a written lease?
Choice of Lease Type

• Landowner and tenant manage yield and price risk by their choice of lease type

• Irrigation...
  – Increases financial commitment
  – Reduces risk of weather-related crop failure
  – Increases expected yield
  – Reduces yield risk but increases price and financial risk

• Changes in risk associated with irrigation may change landowner and tenant preferences regarding lease type

Rental Rate

• Effect of irrigation on rental rate depends on
  – Whether landowner or tenant provides the irrigation equipment and improvements
  – Type of lease (cash or crop share)
Rental Rate

• For a cash lease in which landowner provides irrigation equipment and improvements
  — Landowner would expect rent to increase by an amount at least as much as:
    • The annualized cost of the investment in irrigation equipment and improvements, plus
    • Some positive rate of return on the investment, plus
    • Any variable expenses borne by landowner (e.g., energy/pumping costs)

Help for Calculating Annualized Irrigation Costs
2013 Cropland Cash Rental Rates by ASD ($/ac)

Source: USDA

Rental Rate

- For a *cash lease* in which *tenant* provides irrigation equipment and improvements
  - Tenant might expect rent to *decrease* to the extent that equipment or improvements provided by tenant *increase* value of rented land *beyond the lease term*
Rental Rate

• For a *crop share* lease...
  – Landowner and tenant share of total returns should be in the same proportion as they contribute resources
  – Yield-increasing variable expenses (e.g., energy costs associated with irrigation) should be shared in same percentage as crop is shared to encourage profit-maximizing behavior

Rental Rate

• Crop share example:
  – Landowner only contributes land which is valued at $100 per acre non-irrigated, but $150 irrigated
  – Tenant’s annual contributions valued at $300
  – Should be operating on 1/4 - 3/4 share
    \[
    \text{Landowner: } \frac{100}{100 + 300} = 25\% \quad \text{Tenant: } \frac{300}{100 + 300} = 75\% \\
    \]
  – If landowner provides irrigation, landowner’s share should increase to 33%
    \[
    \text{Landowner: } \frac{150}{150 + 300} = 33.3\% \quad \text{Tenant: } \frac{300}{150 + 300} = 66.7\% \\
    \]
### Lease Term

- Party providing irrigation equipment and improvements would typically expect lease term to be long enough to recoup investment
  - Leases for longer than a year have to be in writing to be enforceable

### Fixtures

- Tangible property that is *incorporated into or attached to* real property *so as to become a part of the real property*
  - *Real property* – land and everything that is *attached to it*
  - *Personal property* – all other property
**Real vs. Personal Property**

<table>
<thead>
<tr>
<th>Land</th>
<th>Physical Alterations to Land</th>
<th>Equipment “Attached” to Land</th>
<th>Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
<td>Real Property</td>
<td>Real Property</td>
<td>Personal Property</td>
</tr>
</tbody>
</table>

**Why do we care about fixtures?**

- Fixtures are owned by the owner of the real property to which they become attached
  - Landowner keeps fixtures upon expiration or termination of a lease regardless of who provided the fixture
  - Landowner may be responsible for maintenance and repair
  - Tenant may not have an insurable interest in a fixture
  - Landowner’s lender(s) may have security interest in fixtures, while tenant’s lenders may not
  - Taxable as real, not personal property
  - Landowner (not tenant) may be entitled to compensation in the event real property is taken by eminent domain
  - Fixture may pass with sale of real property by landowner (absent contrary provision in sale agreement)
What constitutes a fixture?

- Tennessee courts look at three factors in determining whether something is a fixture
  - Attachment to real property
    - Physical or constructive attachment
  - Adaptation to use of real property
    - The more useful an article is in operation conducted on the property, the more likely it is to be considered a fixture
    - The more useful an article is at other locations, the less likely it is to be a fixture
  - Intent of the parties (most important of 3)
    - Evidence of intent to permanently attach
      - For example, whether removal would cause material injury to the real property or other fixtures

Fixtures and Leases

- Presumption that tenants do not intend that articles which they attach to real property will permanently remain permanently a part of the real property
- However, this presumption may be overcome by other evidence of intent
  - For example, whether removal would cause permanent damage
Fixture Cases

• **Rowan v. Riley** (Idaho 2003)
  – In a dispute over land that had been partitioned, well and well casings were held to be a fixture

• **Schwend v. Schwend** (Montana 1999)
  – Plastic irrigation pipe that could be easily attached and unattached to an underground main line via riser pipes and that could be picked up and moved around by 1 person were held not to be a fixture

• **Wyoming State Farm Loan Board v. Farm Credit Capital Corp** (Wyoming 1988)
  – Plastic pipe only intermittently connected to risers was not a fixture
Fixture Cases

  - Tenant removed center pivot irrigation system at end of lease term by digging up underground wires and pipes and unbolting the pivots from cement slabs
  - Court held irrigation system to be a fixture
    - System was annexed to the land because bolted to cement slabs and attached to pipes and electrical wires buried underground
    - System was adapted to the land in that land was used for farming and the system was necessary to farm the land, and the system was adapted to the particular ground being farmed
    - Farmer who installed the pivot system destroyed existing ditch irrigation system, suggesting he intended system to be permanent
Fixture Cases

• *Western Ag. Land Partners v. Washington Dept. of Revenue (Washington 1986)*
  – Center pivot irrigation system was held to be a fixture which passed with sale of the land

• *In re Sand & Sage Farm & Ranch, Inc (Kansas 2001)*
  – Court held that center pivot irrigation system was a fixture and, thus, lender with mortgage had valid security interest (as opposed to lender with security interest in debtor’s “equipment”)
  • Court explicitly considered difficulty and expense of moving the irrigation system ($4,000 - $6,000) relative to the value of the system ($10,000)

Additional Provisions

• Who is responsible for...
  – Insuring the irrigation equipment?
  – Maintaining the irrigation equipment?
  – Paying taxes on the irrigation equipment?

• Restrictions on tenant’s use of irrigation equipment to avoid impact on water supplies?

• What happens at the end of the lease term?
  – Who gets the irrigation equipment?
  – Is compensation owed to the one who provided the equipment?
Additional Provisions

• Compensation for irrigation equipment and improvements at least termination

<table>
<thead>
<tr>
<th>Type of Improvement</th>
<th>Date to be completed</th>
<th>Estimated total cost</th>
<th>Proportion to be contributed by tenant</th>
<th>Total value of tenant’s contrib.*</th>
<th>Rate of annual depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Int. Well</td>
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<tr>
<td>Underground Pipe</td>
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<td>Land Div.</td>
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<td>Tailwater Structures</td>
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<td>Power Lines</td>
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<tr>
<td>Other</td>
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</tbody>
</table>

*To be recorded when improvement is completed.

Source: Langemeier (1996)

Importance of Written Lease

• Longer term implies need for lease to be in writing to be enforceable (Statute of Frauds)
• Need for additional provisions
• Increased importance of other provisions
  – E.g., sub-leasing
• What if lease agreement is silent on a particular issue (or evidence unconvincing)?
  – Apply existing law, if any
  – Two issues
    • May impose burden on landowner or tenant that they would not have willingly accepted
    • There may be little or no existing law and/or its application to the issue may be unclear
Irrigation & Leasing Resources

• UNL Extension in Lancaster County
  – http://lancaster.unl.edu/ag/crops/irrigate.shtml

• Michigan State University Extension in St. Joseph County
Thank You!
Questions?