Characteristics of Agricultural Leases Across Kansas: Results of a Kansas Farm Management Association Leasing Survey- *Part 1*

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http://www.agmanager.info/KFMA/Newsletters/Research/AgLeases.pdf

Introduction

A survey of KFMA member farms was conducted in the fall and spring of 2015 and featured a supplemental form which members were encouraged to fill out by their KFMA economist. A total of 308 surveys were returned. The surveys asked for information on the producer's "most economically important" lease. Responses included information on non-irrigated cropland, irrigated cropland, and pasture. A select few of the responses covered more than one of these land categories. In addition to questions on the terms of the lease, a section was included that asked the producer to answer general questions about the landlord and their leasing relationship. Not all the returned surveys had complete information for all the questions. Therefore, the total number of responses used to summarize each question is given.

Lease Types

The type of lease used by producers and landowner is a reflection of many factors including risk aversion by either party, cash flow constraints, or even tendencies to do business the "way Dad did it". No matter the motivation to choose a particular lease type, having a good understanding of the differences between the two can improve landowner-tenant relations and economic outcomes. For clarity, fixed cash leases are defined in this article as the tenant agreeing to pay a fixed dollar amount per acre for the use of cropland for a single year. There may be other constraints on the lease, but the basic idea is that the lease payment is independent of the yields and prices the producer receives for that year's crop. A crop share lease is defined in this survey as an agreement to use the cropland for a single year with the landowner and tenant sharing both certain input costs and the resulting crop (usually in the same proportion). The basic idea of a crop share lease is that yield and price risks are shared by the tenant and landowner and the net payment to the landowner varies according to those risks. Historically, the use of crop share leases has been common in Kansas, especially for non-irrigated cropland in areas of the state with highly variable crop yields.

Of the lease surveys returned for non-irrigated cropland, 59.9% were fixed cash rent leases and 40.1% were crop share leases. The use of fixed cash leases has been growing over the past 10 to 15 years in Kansas. A survey by Schlegel and Tsoodle indicated growth between 2002 and 2011 from 35% to 45% in Eastern Kansas counties. Motivations for a growing use of fixed cash leases generally fall into two categories: risk management and cost of doing business. The use of crop insurance limits yield and commodity price risk exposure to a producer, making the idea of a fixed cash lease more appealing. For a landowner, fixed cash leases allow them to avoid the year-to-year payment volatility and cash flow requirements of a crop share lease.

While crop share leases are an effective way to share risks, they often require a higher cost of doing business. Landowner and tenant must communicate effectively and frequently on cropping and input use decisions. Landowners must make arrangements to have their portion of the crop marketed and tenants must keep track of grain delivered to the elevator that belongs to their landlord. These additional requirements may not be a heavy burden for farmers with few landlords, but can become burdensome if a producer is dealing with a larger group of land owners. With the tendency in agriculture for farms to increase in size and capture economies of scale, having more landlords, not fewer, is likely to be the trend.

Leasing Relationship

The average number of years a farmer and landowner engage in leasing activities is shown in Figure 1. For crop share leases, the length of the leasing relationship averages 22.3 years, while the length of relationship is slightly shorter for cash leases at 18.7 years. Regardless of the lease type, it appears that leasing relationships last for almost a generation in Kansas, which fits with many stories I hear from people about land being leased between families for three and four generations.

The average length of a lease (time periods between negotiating new lease terms) is 10.9 years for crop share leases and 4.2 years for cash leases, as shown in Figure 1. It is easier for the terms of a crop share to stay in place for 10-11 years because the share format allows the landowner payments to adjust automatically to low/high crop prices or good/bad yield years. However, for cash leases rental rates can easily get out of balance if the profitability of crop production changes from the expectations at the time the terms of the lease were negotiated. Therefore, to keep either the landowner from getting too low or high of a payment relative to profitability the leases are renegotiated approximately every 4 years.

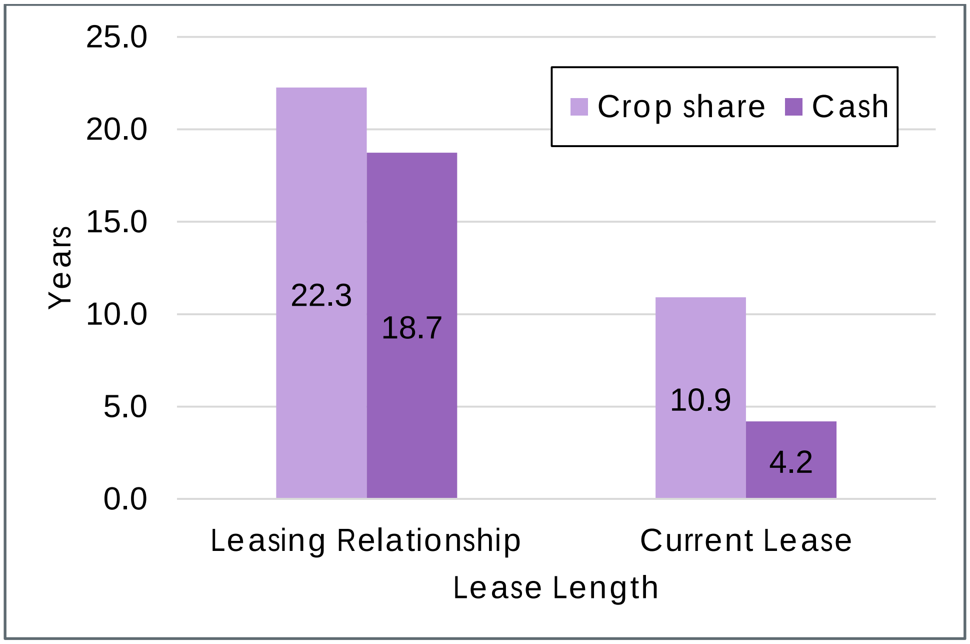

Figure 1. Lease Length

Related to the leasing relationship is the way in which the lease is executed: either as an oral lease (handshake agreement) or as a signed, written document. Either type of lease is acceptable under Kansas law, but oral leases cannot be longer than one year in length while written leases may be variable in length. The breakdown of lease types is shown in Figure 2 and something worth noting is the higher proportion of crop share leases that are oral (75%) versus written (25%). It is possible that the higher levels of communication that are required between a tenant and landowner under a crop share arrangement also support a greater level of trust between business partners and a willingness to engage in a handshake agreement. Cash leases, which can be conducted with less communication between tenant and landowner, appear to rely to a greater extent on written leases to convey the expectations of how the land will be used. Interestingly, many people have very strong feelings about which type of lease is better and negotiations between a tenant and landowner who do not feel similarly about oral versus written leases can lead to misunderstandings.

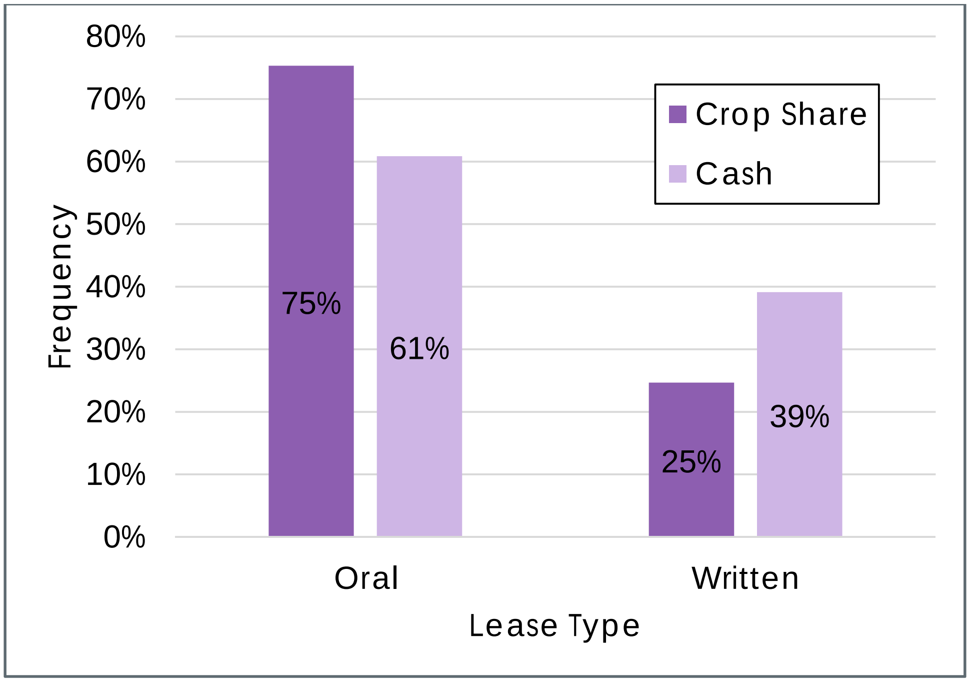

Figure 2. Lease Type

Landowner Characteristics

Gaining a clearer understanding of the variability in leasing arrangements found in Kansas starts with knowing something about the people involved in negotiating these leases. The type of landowner is shown in Figure 3 with three distinct categories of owner given: individuals (including partnerships), trusts, and institutions. Individuals who own Kansas farmland are the largest category and represent 81% of the non-irrigated leases in the survey. These individuals may have purchased the land or inherited it and many times ownership is shared across siblings, cousins, or other relatives. Often trusts represent multiple family members and are managed by a trustee who may be one of the owners, a farm manager, banker, or attorney. Institutions include entities such as municipalities, Kansas Department of Wildlife and Parks, or Native American tribes. The forth category shown in Figure 3 shows that, of all the different categories or land owners, 11% of the leases they hold are managed by someone other than the landowner. This is likely a professional farm manager.

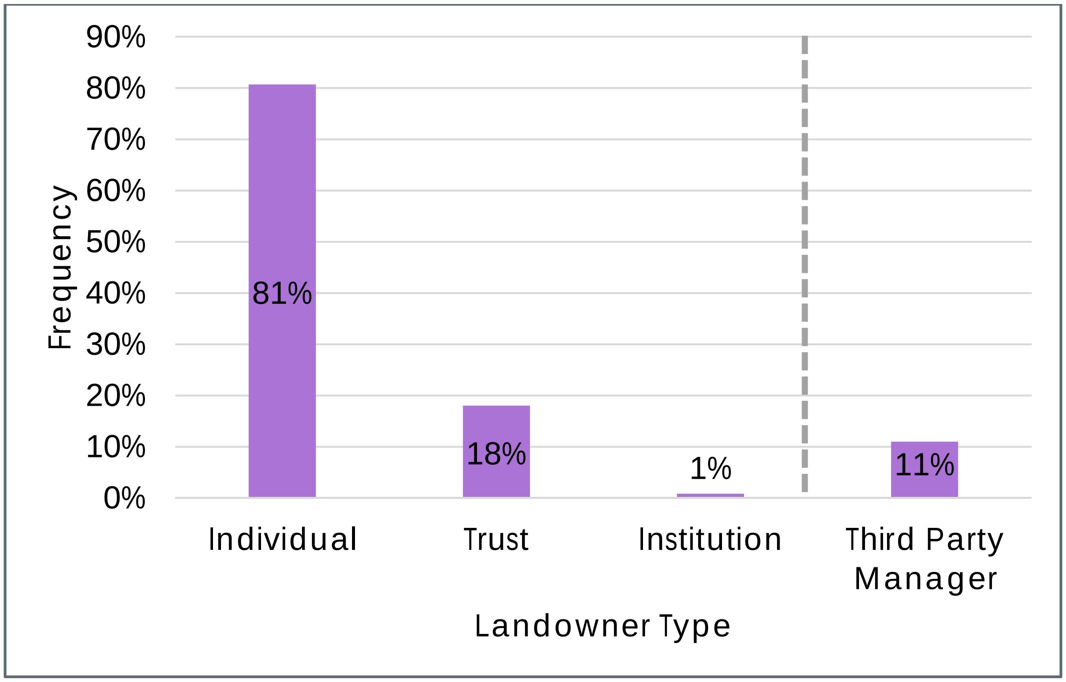

Figure 3. Landowner Type

The average age of a Kansas farmland owner, according to this survey is 72 years. The distribution of landowner ages shown in Figure 4 reveals that people often become farmland owners later in life. This is likely a result of several factors including inheriting the land after their parents pass away, being retired farmers, or not being able to purchase land until later in life when they have the cash to pay for it. It is possible that the decisions a landowner makes are motivated by their age and/or their financial situation. For example, the rent from their farmland may be their primary source of income in retirement. If that is the case, the landowner may shy away from crop share leases with variable annual payments in favor of a cash lease with fixed annual payments. If the landowner were much younger and viewed the rent from their land as a contribution to a future retirement fund, getting variable payments from a crop share might be preferable.

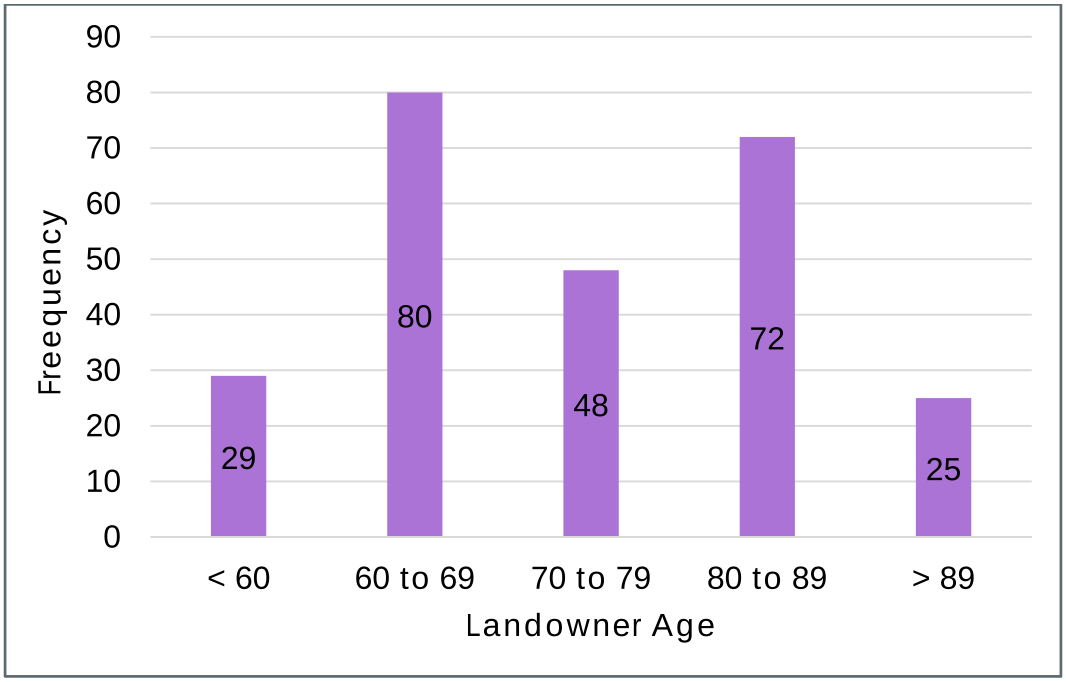

Figure 4. Distribution of Kansas Landowner Ages

Survey respondents also answered questions about where their landowner resides. The categories, shown in Figure 5, include living in the same county as their farmland, living in a different county than their land, and living outside the state of Kansas. The largest proportion (52%) of landowners reside in the same county as their farmland, followed by landowners who live outside the county (31%), and those who live out of state (18%). This importance of where a landowner resides becomes especially important when considering how best to communicate information about their lease. If a tenant is renting from someone they are likely to see at the grocery store or can easily drive to visit them, perhaps communication is both easier and more frequent. Landowners who live away from the farms (often referred to as absentee landowners) are more likely to communicate by phone, mail, or email. Absentee landowners may only visit the farm once a year or even less often. This situation puts the burden of communicating information about the farm on the tenant.

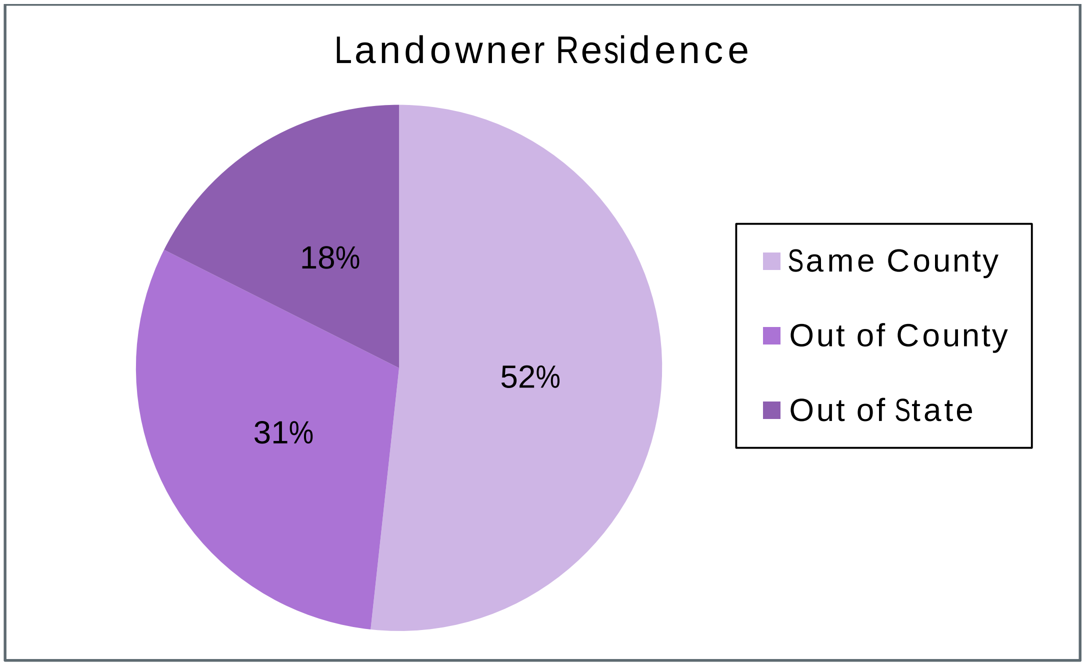

Figure 5. Landowner Residence

It is difficult to draw sweeping generalizations about how landowners and tenants negotiate leases or how their leasing relationships work. Many factors enter into how people approach these business dealings, but it may be helpful for both farmers and landowners to think about what motivates the other person in the leasing relationship as they try to make these arrangements work for both parties. It will also be useful in the long run to track how the factors change and what implications are seen in the leasing market.

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