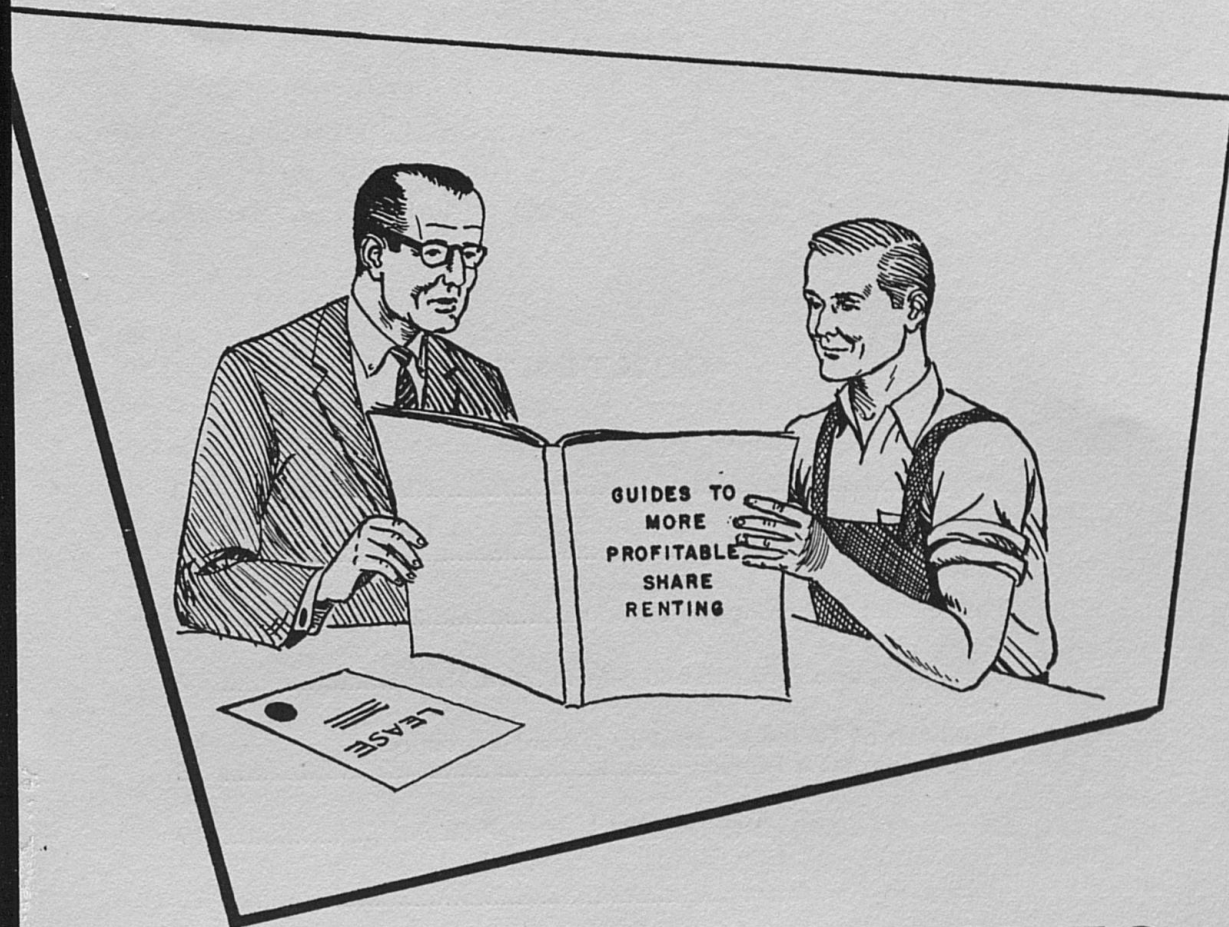


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GUIDES TO MORE PROFITABLE SHARE-RENT FARMING

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Guides to More Profitable Share-Rent Farming

By HARALD R. JENSEN and ALVIN C. EGBERT

Most tenants and landlords have been dissatisfied with their rental agreement at one time or another. Sometimes one or the other feels dissatisfied with the initial agreement. In other instances both parties feel entirely satisfied with the initial agreement, but changes in farm prices and production techniques cause either tenant or landlord to view the initial agreement as no longer fair or equitable. Problems can easily arise where farm production resources (labor, machinery, livestock, buildings, land, etc.) are owned separately but controlled jointly. Finding solutions to rental problems is often difficult simply because information on adequate rules or guides is lacking.

In this publication, share renting problems and possible solutions are discussed to encourage both tenant and landlord to use their production resources to obtain more profit from the farm. However, the solutions presented are not a cure for all tenant-landlord problems. All such problems do not grow out of how ownership of resources, how expenses, and how crop and livestock production are shared. Rental agreements, like other agreements, involve more than one person. Where more than one person is involved personality conflicts may arise. Solution of personality problems may be as important as solution of sharing problems if rental agreements are to work well. Although personality conflicts are recognized here as problems in rental agreements, the following discussion deals only with problems of sharing resources and products.

WHY RENT A FARM?

Many tenants and landlords have at some time asked themselves: Why do I rent? For some, the answer is clear, for others, it only seems clear. For example, a widow may be certain she is renting out the farm because she is unable to operate it alone.

This inability she may attribute entirely to her labor limitations. Actually, she may also be without training in farm management and/or lack sufficient cash and equipment for operating the farm properly. Similarly, an absentee landlord may be certain that he bought the farm for an investment or for sentimental reasons. However, his reasons for renting out the farm may not be entirely clear when he considers the alternatives of renting out the farm, of hiring a manager and laborers, or of hiring labor and using his own management. The tenant may be certain that he is renting because he has to make a living. Yet, when he considers that he could borrow to buy some land, or work as a farm hand or as a wage earner in town then his position as a renter may not be entirely clear to him. But whether a widow, or an absentee landlord, or a tenant, one basic reason for renting is to get control of the services of labor, machinery, land and other resources.

Getting control of resource services

Many people view hiring of labor or machinery as something distinctly different from renting a farm. Let us examine this notion. A man is hired to perform work. This work is a service to the employer. In return for this service, the employer pays the laborer money. This money can be used to buy goods (food, clothing, etc.) and other people's services (doctors', lawyers', painters', etc.). When a farmer contracts to have a pond dug he hires the services of both machinery (capital) and labor. The point here is that both things and people are hired to do a job. By and large, renting a farm is no different. The tenant hires the services of the landlord's land, buildings and perhaps some equipment for growing and housing crops and livestock, while the landlord hires the services of the tenant's labor, equipment, and some management to care and plan for crops and livestock.

The only difference between renting a farm and hiring labor is that labor is usually hired for some fixed sum of money whereas payments between the landlord and tenant are either fixed or variable, in money or in kind (cash rent is usually fixed and in money while share rent is variable and in kind). In either case productives services are being exchanged for something of value—money, or crops or livestock. Thus, when labor or machinery is hired or a farm is rented one party is buying from another party

services that he needs to add to his own resource services to have a productive unit. This procedure is known as getting control of resource services.

There are three methods of getting control of resource services. These are buying, hiring (renting or borrowing) and inheriting. Many times farmers and businessmen find it more practical to hire the services of resources rather than to buy the resources themselves. In our society, the services of labor must always be hired; laborers themselves cannot be bought. However, all other resource services can be obtained by hiring (renting or borrowing) or by buying the resources themselves. Farmers often find it advantageous not only to hire or rent the services of resources not owned (such as using artificial insemination rather than owning a bull or renting land rather than owning any), but frequently also find it advantageous to supplement the services of resources already owned with hired or rented services (such as hiring additional machine services or renting additional land).

Each tenant and landlord, when making a share rental agreement hires (rents) productive services that he does not own to supplement those he does own. Tenants hire the services of land and buildings, of which many have none, and often hire the services of additional capital in livestock and machinery to supplement that which they own. In turn, landlords hire (rent) the services of labor and of additional capital in machinery, and perhaps in livestock to supplement that which they own. In many instances, farming could not take place at all if farmers had to buy and own all of the resources needed for farming. Furthermore, if every farmer were to buy and own all the resources necessary for operating his own farm, farm production would be less efficient than at present.

The easiest and cheapest way to get control of resource services is of course to inherit resources. But many are not that fortunate. A second basic reason for renting is to make one's own resources more productive.

Increasing resource efficiency

Increase in resource efficiency can be achieved in two ways. First, when a given quantity of resources (capital including land, labor and management) is reorganized to produce a greater prod-

uct, resources are used more efficiently. For example, suppose a farmer is growing 50 acres of corn. Of these acres, he owns 35 and rents 15 for \$15 per acre. He has money enough to apply only a small amount of fertilizer which he distributes evenly over the 50 acres and gets a total yield of 1,500 bushels. He then decides against renting the 15 acres and uses the rent money to buy more fertilizer to put on his own corn land. With the added fertilizer he now produces a total of 1,700 bushels of corn instead of 1,500. He uses the same total quantity of resources as before, but by reorganizing them to include less land and more fertilizer he produces more corn.

Second, resources are also used more efficiently when the same amount of product is produced with fewer resources. To illustrate, suppose a farmer is carrying 30 beef cows and their calves on a given acreage of pasture. From this herd, he produces about 8,500 pounds of beef annually. Since this size herd results in overgrazing of pasture, he decides to sell five cows. With fewer animals but more feed per animal, he produces the same quantity of beef. Hence, fewer resources are being used to produce the same quantity of product.

Increases in resource efficiency from renting, resemble the first situation above. To illustrate, suppose a farmer owns a large acreage but has insufficient capital, labor and management to operate it efficiently; he could sell part of his land and with his added money and his other resources produce the same crop and livestock output as before. Another farmer has a small acreage but has more labor, machinery and management ability than he can utilize fully. By combining their resources through a rental agreement more could be produced than when the two farmers operate their farms separately. Of course, hardly ever does renting involve combining resources of two farms. Rather it involves combining the landlord's resources of land, buildings, other capital items and management with the tenant's resources of labor, capital and management. However, in either case the effect is much the same. More product is obtained by reorganization or combination of a given quantity of resources. Hence, in many instances renting helps to promote greater resource efficiency.

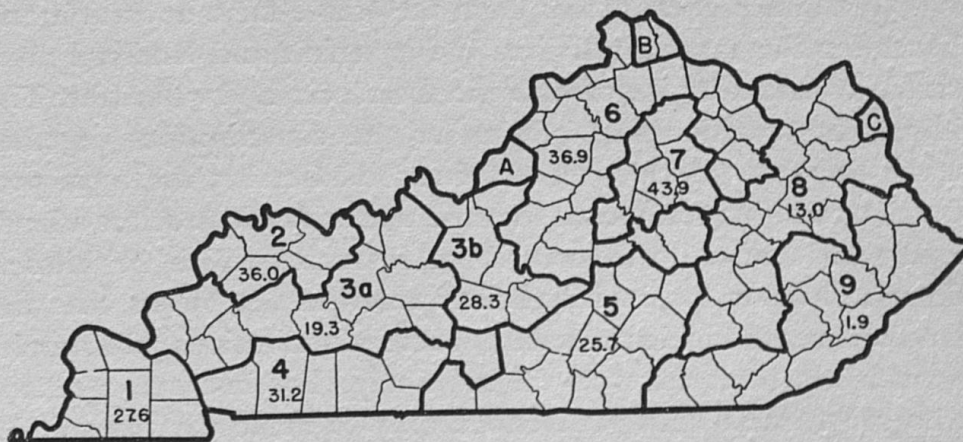
THE AMOUNT OF RENTING IN KENTUCKY

Many persons realize that by renting they can engage in farming and improve their incomes at the same time. The number of tenant farmers in Kentucky at the time of the last U. S. Census (1950) supports this statement. Of a total of 218,476 farms, 49,112 or 22.5 percent were tenant-operated. Of course, the proportion of tenants varies considerably from one area to another within the state as Table 1 and Fig. 1 show. Generally, the areas with the more productive (higher value) land also have the most tenants. This association may mean that beginning farmers in the more productive areas have insufficient capital to buy farms in these areas and that income-wise they prefer to rent land in the

Table 1.— Farm Tenancy in Kentucky by Economic Areas, 1950

(1) Economic Area	(2) All operators (number)	(3) Full tenants (number)	(4) Full tenants as a percent of all operators (percent)	(5) Part tenants (numbers)	(6) Part tenants as a percent of all operators (percent)	(7) Full tenants and part tenants as a percent of all operators (percent)
1	15,134	2,038	13.5	2,136	14.1	27.6
2	8,267	1,632	19.7	1,342	16.3	36.0
3a	21,163	1,931	9.1	2,155	10.2	19.3
3b	13,394	2,237	16.7	1,560	11.6	28.3
4	18,092	4,433	24.5	1,954	6.7	31.2
5	29,245	4,143	14.2	3,370	11.5	25.7
6, A & B	43,986	11,994	27.3	4,226	9.6	36.9
7	11,916	3,932	33.0	1,302	10.9	43.9
8, & C	28,746	1,966	6.8	1,778	6.2	13.0
9	28,294	321	1.1	236	.8	1.9

Source: U. S. Census, 1950.



more productive areas rather than to buy small farms in less productive areas. The table further shows that many owner-operators rent additional land. Apparently, they find it economically advantageous to supplement their own with rented land.

As indicated, renting provides opportunity for combining resources to attain higher incomes. However, to realize this opportunity certain basic problems must be worked out.

OVER-ALL LEASING PROBLEMS AND HOW TO SOLVE THEM

Renting creates problems peculiarly its own. People who have had first-hand experience in renting can appreciate problems such as selecting a tenant or a landlord and working out arrangements for sharing investments, products and expenses. We now examine these basic problems and offer guides for solving them.

Selecting a landlord and a tenant

To make their farming operations succeed, tenants and landlords need to select each other with care. Each must consider a number of things before he decides, "This is the farm for me" or "I want this man to operate my farm."

The landlord normally contributes land, buildings, some management skill and working capital—cash for operating expenses, and quite frequently breeding and feeding livestock. The tenant usually contributes labor, some or all of the management skill and working capital—machinery, cash for operating expenses, and breeding and feeding livestock.

To attain highest profits from the whole farm operation and hence for themselves individually the tenant and landlord must carefully inventory the contributions each can and will make. The important consideration is whether the contributions together make the most productive combination. Getting the most productive combination means that the tenant needs to select a landlord who can and will contribute resources which he himself doesn't have or has in insufficient amounts. It means that the landlord needs to select a tenant whose contributions will supplement his own resources in the same way. For instance, a tenant who can furnish enough livestock only to make part use of the available feed, buildings, management skill, labor and other re-

sources needs to select a landlord who can and will contribute the livestock necessary to efficiently use these resources. The landlord, likewise, who can furnish either little or no labor needs to select a tenant who has the labor, machinery and other resources to make efficient use of his land, buildings and other resources.

As tenant and landlord view each others' resource contributions to see how they dovetail together, they need also to evaluate the quality of these contributions. For example, a landlord may have enough land to make efficient use of a tenant's labor, machinery and other resources. But if the soil is inherently poor, the tenant's labor, machinery and other resource contributions cannot be expected to be very productive. In other words, a tenant with high quality labor, machinery and other resources would be unwise to match or combine these with soil or other resource contributions which are basically poor. Similarly, a landlord may have a highly productive farm but be in no position to furnish any management skill. He would fail to realize the production and income that he should, if he selects a tenant with low management skill or who has low quality machinery and equipment.

Thus, to get the highest income-producing combination of resources, the resource contributions of the one must be in proper balance with those of the other. To attain this balance, tenants and landlords need to select each other on the basis of how well their resource contributions fit together in terms of kind, amount and quality. Together they should have the quantity and quality of resources which approach as nearly as possible that used by the ideal farm business. More specifically, together they should have that quantity of resources which makes it possible for them to extend their uses to where the last unit of any one resource just pays for itself or to the point where their use is consistent with financial safety. Furthermore, to make the combination as productive as possible, the quality of each party's resource contributions should match that of the other party's.

Sharing cash production expenses

Once a tenant and a landlord have mutually selected each other, the next problem is how to share out-of-pocket production expenses such as tractor fuel, lubricants, most seeds, feed bought, fertilizer, veterinary fees and others of similar nature. Not in-

cluded are cash expenses such as insurance and taxes.¹ Insurance is a precaution against uncertainty. When a person takes out insurance he pays a relatively small cost in premiums to prevent an uncertain large loss. Premium payments are not inputs which contribute to production. The same is true of taxes. Payment of taxes represents only the privilege to carry on production. Thus, only annual expenses which contribute to production are considered here.

A number of different ways of sharing expenses are used in rental agreements. A recent study of rented farms in central Kentucky showed that for a given enterprise some expenses were shared in the same proportion as the product while other expenses were paid entirely either by the landlord or by the tenant. For other enterprises, each party might pay all of individual expenses. For example, in corn production the tenant often paid for all of the seed and for all the machinery operating expenses while the landlord paid for all the fertilizer. On the other hand, in hay production the tenant paid for all the machinery operating expenses while the landlord paid for all the seed, lime and fertilizer. The annual individual out-of-pocket expenses per acre approximated the following:

	Corn		Hay	
	Tenant	Landlord	Tenant	Landlord
Machinery operating expenses	\$2.61	\$0.00	\$1.88	\$0.00
Seed	1.80	0.00	0.00	2.50*
Fertilizer	0.00	5.44	0.00	5.44
Lime	0.00	0.00	0.00	1.10
Total	\$4.41	\$5.44	\$1.88	\$9.04

* Alfalfa and orchard grass seeded for 2 years.

If tenant and landlord view these expenses separately, the tenant will want the landlord to apply fertilizer on corn as long as it can be expected to increase the yield. In other words, the tenant will want the landlord to apply fertilizer up to the point where the last bag of fertilizer or fraction of a bag adds no more than an ear of corn. On the other hand, the landlord will want the tenant to increase the rate of planting seed corn as long as it can be expected to increase yields. He will want the tenant to increase

¹ Real and property taxes should be paid by individual resource owners. The same holds true for insurance costs on buildings, machinery, livestock, etc. Crop insurance, however, should be shared in the same proportions as gross income is shared.

the number of cultivations and other tillage practices and thereby his machinery operating expenses for corn to the same extent. What has been said for corn when the landlord and tenant view production expenses separately also applies to hay. The point is: When each party pays all of individual expenses and the parties come to view these separately, then the one not paying a particular expense will want the one who does to increase the expenditure far beyond the point where profits are greatest for him. The end result is losses in income and poor working relationships.

Rather than viewing these expenses separately, tenant and landlord may view them as amounts that must be used together as a bundle to produce individual products. Looking at expenses in this manner, either party will want to shift resources to the enterprises where each can expect the highest returns above their individual expenses. To illustrate, suppose that the tenant and landlord plan to produce either 100 acres of corn or 100 acres of hay. From the 100 acres they expect either 5,000 bushels of corn at \$1.60 or 250 tons of hay at \$32.50 or a gross return of \$8,000 from corn or \$8,125 from hay. With individual expenses for corn and hay as outlined above and with a 50-50 sharing of the product, tenant and landlord returns above out-of-pocket expenses are as follows:

	Landlord		Tenant	
	Corn	Hay	Corn	Hay
Value of share	\$4,000	\$4,063	\$4,000	\$4,062
Share of expenses	544	904	441	188
Returns above cash expenses*	3,456	3,159	3,559	3,874

* To simplify the illustration only cash expenses have been considered.

With expectations based on the foregoing returns, the tenant will want to shift resources to hay while the landlord will want to shift resources to corn. Of course, the landlord may recognize the soil-conserving and yield-increasing effects of grass-legume sods on other crops and, therefore, want to grow some hay. But regardless of the amount of hay the landlord would like to grow, the tenant will want to grow more. Although the above-mentioned analysis has been applied to corn and hay it applies to all other farm enterprises where similar lease arrangements are involved.

Thus, when product and expenses for individual enterprises are shared in a manner to give the tenant and the landlord the

highest profit advantages in different enterprises conflicts can develop. Such conflicts, however, could be avoided very easily by deciding to share all annual cash production expenses without reference to how the product is to be shared. The reasons for making no agreements on product sharing at this stage will become clear at a later point.

The proportions in which the annual out-of-pocket production expenses are shared are unimportant for efficient operation of the farm and for making a fair lease. The important thing is that **all** of these expenses are shared and shared in the **same proportions**. The amount of cash that the tenant and landlord each can contribute should determine the proportions in which to share these expenses. The landlord may know or the landlord and tenant together can estimate the total amount needed for these expenses. If the amount is \$4,000 and the tenant can furnish \$1,600 and the landlord \$3,400, then all individual expenses making up the \$4,000 should be shared two-fifths, three-fifths—two-fifths by the tenant and three-fifths by the landlord. On the other hand, if the tenant can furnish only \$1,000 of the \$4,000 while the landlord can furnish \$3,000, the tenant should then pay one-fourth of these expenses and the landlord should pay three-fourths. Obviously, when the tenant and landlord select each other it becomes important for each of them to know what the yearly cash production expenses for the farm are going to be and how much cash each can furnish. If the amount needed is \$4,000 and the landlord can furnish only \$1,000, he should not be looking for a tenant who can furnish less than \$3,000.

When agreement has been reached on how to share annual cash production expenses, the next problem is how to share non-cash production expenses.

Sharing noncash production expenses

Noncash production expenses are the annual amounts used up in production of capital items such as machinery, breeding livestock, buildings and other improvements. In addition, noncash production expenses include the annual contributions of land and of all labor (operator and family) other than hired. The amounts of capital items, such as machinery, buildings and breeding livestock, annually used up in production are usually measured by

depreciation.² The annual contribution of land to production is usually measured by a mutually agreeable rate of return on the current investment value, while the contribution of labor other than hired is measured by use of current wage rates.

The over-all guide for sharing noncash production expenses is: Share them on the basis of who furnishes the capital items (including land) and nonhired labor. For example, the landlord usually furnishes land, buildings and other permanent improvements. Hence, the annual contribution (noncash production expenses) of these items is the landlord's. Similarly, if the tenant furnishes all the machinery and non-hired labor, the noncash expense of depreciation on machinery and the annual contribution of nonhired labor are the tenant's. On the other hand, if tenant and landlord both furnish some machinery then each is charged with the noncash production expense (depreciation) of the items he furnishes. The same is true for breeding livestock and non-hired labor.

Thus, it makes no difference who furnishes a particular investment as long as the one who furnishes it has the opportunity of realizing full return on it. In other words, the investor should have the opportunity to receive the same return that an owner-operator would receive from a like investment. If the investor is not assured of a full return on an investment, he will not wish to make it and if he is forced to make it, conflicts are likely to develop.

To help make certain that the investor will receive full return on his investment and to help prevent conflicts, tenants and landlords should share noncash production expenses in line with their contributions of capital items and nonhired labor. Hence, in leasing either party can make all of an investment, assume the entire noncash production expense of it and receive a larger share of the total product, or both parties can share the investment, share the noncash production expense of it in the same proportion and both share the larger total product.

Contrary to what is sometimes believed, neither fairness of lease nor maximum farm profits depends on a 50-50 sharing of

² Some breeding livestock may have no depreciation since the salvage value (because of gain in weight) is equal to current value. Beef cows, for example, may have no annual depreciation. In this instance, however, the estimated value of annual death loss would represent a noncash production expense.

investments. Many business partnerships are set up where both parties are unable to contribute like amounts, but each benefits from the pooling of resources. The same holds true for tenants and landlords.

There is no logical reason why a tenant and a landlord should put off an agreement just because, say, the tenant is unable to match the landlord's resources with a like amount. Of utmost importance, however, is to make the lease provisions in such a way that each party can receive full return from any investment he makes. When cash and noncash production expenses have been determined for the farm as a whole and when the sharing of these expenses have been mutually determined, then the problem of how to share the product is also solved.

Sharing the product

The gross farm income should be shared in the same proportions in which cash plus noncash production expenses are shared. Thus if the tenant contributes one-fourth, one-third, one-half, three-fifths or any other amount of cash plus noncash production expenses he then receives the same proportion of the gross income. This procedure is followed generally by business partnerships. In business, it is the total proceeds from the sale of all the products which are shared.

Most of the time, landlord-tenant operations do not follow this procedure for all crops and livestock produced. More likely, the agreement provides that each party is to receive a certain share of each product. For instance, the provision may be for each to receive one-half of the tobacco, corn, oats, lambs, hogs, and other products. According to this provision, each is often free to sell the individual products when or where he expects to get the highest price.

When products are sold separately, chances are good that eventually they are going to be shared in different proportions. Coming to share products in different proportions can be a perfectly natural adjustment in rental agreements in order to give the tenant or landlord a "fair" share of the product. For example, the landlord may build a new sheep shed. In order to keep the share of gross income from sheep "fair," the tenant agrees that the landlord is to receive two-thirds of the lambs and wool while other

products remain on a 50-50 sharing basis. As long as the landlord shares the annual expenses on sheep in the same proportion (two-thirds) as the products from sheep, this arrangement is frequently looked upon as satisfactory. Yet under particular price relationships, landlord profits may be highest if all sheep and no hogs are produced, while tenant profits may be highest if all hogs and no sheep are produced.

A simple example can illustrate this point. Suppose that the combined tenant and landlord resources of \$600 (the amount annually used up in the production process) yield \$800 worth of lambs and wool. The same amount of resources yields \$750 in hog production. The landlord receives two-thirds share and one-half share of the sheep and hog production respectively and pays two-thirds and one-half of the annual costs in sheep and hog production respectively. The tenant receives and pays the remaining proportions of the returns and costs. With these arrangements, net returns from sheep and hogs for the tenant and landlord are as follows:

	Sheep		Hogs	
	Landlord	Tenant	Landlord	Tenant
Share of product	\$533	\$267	\$375	\$375
Share of costs	400	200	300	300
Net returns	133	67	75	75

Obviously, with these arrangements and the price relationships reflected here, the landlord will want the entire \$600 devoted to sheep production while the tenant will want the \$600 used in hog production. Only when gross income from hogs drops below \$734 while gross income from sheep remains unchanged would both tenant and landlord receive greatest net income with the \$600 used for sheep production.

The point illustrated with this example is often overlooked by tenants and landlords when making an agreement. Consequently, conflicting interests may develop over time. In the foregoing illustration, if the sharing arrangements for sheep were the same as for hogs (50-50 for contributions and returns) or if they were the same for hogs as for sheep ($66\frac{2}{3}$ - $33\frac{1}{3}$ for contributions and returns) there would be no conflict. Both tenant and landlord would want to use the entire \$600 for sheep production, which is also what an owner-operator would want to do.

Thus, the guide for sharing products is: All products should

be shared in like proportions, and these proportions should be the same as those for the contributions (cash plus noncash production expenses).

THE EFFECT OF TENURE UNCERTAINTY (TENANT INSECURITY) ON PROFITABLE FARMING

Some leasing agreements cause large amounts of tenure uncertainty. Many of these are one-year contracts without compensation provisions for investments which yield returns over several years. Also, leasing agreements often fail to provide compensation for acts of disturbance and neglect, and to include provisions for terminating the agreement. Such agreements invite losses in income over the long pull either because of the farming plans or the conflicts which are likely to be associated with them. However, leasing agreements can be made to include provisions which will reduce tenure uncertainty and as a result promote more profitable farming over time.

Tenure uncertainty and year-to-year planning

A tenant who isn't sure he will be on the same farm next year will want to operate the farm he is now on so as to get the highest dollar returns within the year.¹ Farms operated on a year-to-year basis are not necessarily the ones which yield the highest income over time.

Cash-crop farming, for example, particularly if it emphasizes row crops, may yield highest income within the year or over the next few years. But if it results in excessive soil loss and deterioration, incomes over time may be lower than if the cropping system included soil-conserving crops like grasses and legumes.

One study which illustrates this point showed that 100 acres planted to continuous corn over the eight-year period, 1933-40, averaged a net return from crops of \$1,081.² During the same period on the same kind of soil 100 acres with a cropping system of corn-oats-clover averaged a net return from crops of only \$404. In the area studied, use of corn acreages for other crops always

¹ Other factors, such as financial safety, are also likely to be considered in the plan of operation, but the important point is that emphasis in the plan will be for the immediate future.

² Iowa Agr. Exp. Sta. Research Bulletin 383, "The Economics of Crop Rotations and Land Use" by E. O. Heady and H. R. Jensen, August 1951, Ames, Iowa.

lowers income within the short run. However, over the 16-year period, 1933-48, the 100 acres planted to continuous corn averaged a net return from crops of only \$562 while the 100 acres with the 3-year crop rotation averaged \$1,062. The reason why the 3-year rotation averages more income over the 16-year period than continuous corn is because of the yield-increasing effects of clover sods on grain.¹ Grasses and legumes grown in rotation with other crops increase per acre yields of these other crops by (1) adding nitrogen, (2) preventing soil loss, (3) improving soil tilth, and (4) helping to control insect pests and crop diseases. But these yield-increasing effects of grass-legume sods on other crops are reflected only over time. Several rounds of the rotation may be required to reflect the full yield-increasing effects.

Obviously, a tenant who has control of the cropping program on a farm and who has only year-to-year tenure certainty will want to grow those crops that yield the highest return per acre in a single year. Accepting a smaller return this year by diverting grain, fiber or other crop acres to grasses and legumes in order to get a higher average return over several years is simply not within his planning horizon. Consequently, unless specific crop rotations are spelled out in the lease, both tenant and landlord may have less crops and livestock to share over time. Even though the lease does specify the crop rotations to be used, the tenant is likely to be reluctant to use his utmost skill in following it because he realizes he may not receive the full product of his efforts.

Contour farming and proper care of terraces may be points of conflict between tenant and landlord when the tenant has no assurance of long-term tenure. From a year-to-year point of view, soil erosion affects the tenant's income very little. It is only when he views his tenure with certainty over time that conservation farming appears profitable.

Provisions for reducing tenure uncertainty

However, special rental provisions can eliminate inefficiencies and conflicts that stem from farming on a year-to-year basis, even though no long-term agreement exists. With special rental provisions, both tenant and landlord can plan for a trial period when

¹ Prices and costs were held constant at the 1940-44 level. Hence, differences in income are not due to changes in prices and costs.

the initial agreement is made and at the same time farming operations can be planned to get the highest income over time. These special provisions should include payments for unexhausted improvements. Unexhausted improvements or investments are those which are not fully depreciated in one year. For example, tenant and landlord may pool some of their capital to establish a good meadow. Ordinarily this investment yields an income for a number of years until it is plowed up for replacement by other crops or for reseeding. If the tenant is forced to move before the meadow is plowed up, he has not received the full return on his investment. Fertilizer and lime not used up in a year are other examples.

When provisions are made in the rental contract for payments for unexhausted improvements, the tenant will be as interested in considering the improvements as the landlord. Whether the improvements are exhausted in one or two years or give off services over a much longer period of time will make no difference as long as the provisions offer the tenant profit opportunities similar to those open to an owner-operator. Hence, payment provisions for unexhausted improvements require (1) that a depreciation schedule be set up to determine the unused portions of an improvement in any given year, and (2) that an interest rate be agreed upon to represent a return on the tenant's investment. If the tenant is assured only of recovering the unused portion of the investment he is unlikely to make the investment in the first place. Other investment opportunities will appear more attractive to him, particularly those which can be expected to recover the original investment plus normal profits within the year. For this reason the tenant must have assurance of being able to recover more than the original cost of the unused portion of the investment.

Compensation provisions in the rental agreement stand to promote greater security in farm tenure and more profitable farming over the long pull. Compensation provisions in rental agreements can be made not only to cover unexhausted improvements but also to cover acts of negligence or disturbance. Negligence is decrease in value of land, buildings or other landlord resource through improper use by the tenant. Disturbance is an act by the landlord to make the tenant move prior to termination of the contract or an act by the tenant to move off the farm without due cause. Due cause can be defined in any way agreeable to the ten-

ant and landlord. Any provision in the contract, then, which is not fulfilled by either party can be considered as due cause.

Of concern to many tenants and landlords is how to terminate rental agreements. It is well to spell out how it should be done at the time the original agreement is made. Some time before the end of the production period the party terminating the agreement should notify the other party who then can make plans for future production. Time of notice should be mutually agreeable to both parties. If notice is given after the time agreed upon, the compensatory payment for disturbance, worked out in the initial agreement, would be forthcoming.

Compensation provisions in lease agreements are not new. They are used in this and other countries. In England, Scotland and Wales, particularly, they have had long and extensive use. The primary purpose of compensation provisions is to set up incentives on tenant-operated farms similar to those on owner-operated farms, i.e., incentives for the most profitable use of tenant and landlord resources, not only in a short period of time, but also over the long run.

SUMMARY OF SOLUTIONS TO OVER-ALL LEASING PROBLEMS

1. Tenant and landlord should have sufficient resources of the kind and quantity to permit maximum value of production from their combined resources. Their own management know-how, observation from efficiently managed farms in the area, counsel from agricultural college personnel and from commercial farm managers are possible means that tenants and landlords can use in fitting their resources together into an efficient production unit.

2. Particular investments can be either owned individually or shared. The important point is that the owner should have the opportunity to receive full returns on his investments.

3. All cash production expenses should be shared and shared in the same proportions. Noncash production expenses should be shared in line with contributions of capital and nonhired labor items.

4. All products should be shared in the same proportions. These proportions should correspond to the proportional contributions of cash plus noncash production expenses.

5. Compensation provisions should be included in the rental agreement to compensate the resource owner for unused portions of the investment, for negligent use of property and for disturbance or untimely breaking of agreements.

MAKING AN AGREEMENT

This section describes how a tenant and a landlord go about making a leasing agreement based on the guides outlined in the preceding sections. In this way the reader can more clearly see how these guides can be applied.

Selecting farm, landlord and tenant

Jones, a farmer, is planning to retire from active farming as soon as he can find a suitable tenant for his farm. He has a highly productive 185-acre farm. Recently, he was offered \$340 per acre for it. Since he has no vocation other than farming, he decided against selling it. He wants to stay in farming on a limited basis. His farm has a 7-acre tobacco base and adequate buildings and fences for sheep, beef cattle and hogs.

Jones has 15 beef cows, 1 bull, 53 ewes, 2 rams, 4 sows and 1 boar. He considers his machinery and operating capital (money for annual expenses) inadequate for efficient operation of the farm. His decisions to use income for building up the soil and making other permanent improvements have left him short on funds for other expenditures. He estimates his machinery is worth only about \$2,800, and he has \$1,000 in cash. He has been borrowing around \$2,000 for annual expenses. He could have borrowed more but prefers not to operate extensively on credit.

Jones is looking for a tenant with considerable skill in tobacco and livestock production, with some family labor, with more machinery and equipment than is now on the farm and with a fair amount of operating capital or credit to make such an amount available. For some time, Jones has sought a tenant with these qualifications and assets, but so far he has been unable to find one who "fills the bill." Last week, Jones thought he had found one who would qualify, but the prospective tenant had only a few pieces of machinery, which were similar to Jones' own, and cash plus credit of about \$1,500. Obviously, these assets didn't dovetail too well into Jones' own to make an efficient unit. Hence,

with this man as tenant, Jones felt the farm could not be operated any more efficiently than in the past.

Brown is a tenant who lives in a neighboring county. For some time he has been dissatisfied with the farm he is on. The reasons are that his landlord refuses to provide an adequate water supply for livestock (Brown has had to haul water many times during the summer months) and to go into hog production with Brown. While in town recently, Brown met a tenant who farms near Jones. In their conversation, Brown mentioned how dissatisfied he was with his rental situation and the other tenant in turn told Brown about the opportunities on Jones' farm. The very next day, Brown went to see Jones.

As soon as the conversation had served to awaken mutual interests, Brown asked to see the farm. While looking over the farm, Brown asked Jones questions to get his ideas on farm organization and practices and Jones in turn got Brown to tell about his experience and record as a tenant farmer. When they had toured the farm, Jones said to Brown, "Now that you have had the opportunity to look over my farm, to appraise it, to observe how it is equipped and stocked, suppose you now indicate the resources you can furnish so that we can see whether your resources fit in with mine to make an efficient combination." Brown enumerated his resources as shown below:

Labor	
My own	12 months
My son's (16 years old)	3 months
Machinery	
2 tractors (1 old)	
1 truck, 1½ ton	
2 wagons	
2 plows	
1 cultivator	
1 disk	
1 cornpicker	
1 tobacco setter	
1 rake, s.d.	
1 mower	
Miscellaneous tools	
Total estimated value of machinery	\$4,500
Livestock	
50 percent interest in livestock on farm which I now operate. Estimated value	\$2,500
Cash and Credit	
Estimated amount	\$1,500
Farm management and operating experience	
15 years of experience in raising tobacco and other crops and in caring for all kinds of livestock	

Jones then went to the farm Brown was farming, looked over his stock and equipment and generally appraised the kind of job Brown had been doing while keeping in mind the short-comings of Brown's lease agreement. It appeared to him that with a few shifts in resources (machinery to operating capital and livestock), Brown and he could organize and operate an efficient farm business. Brown came to a similar conclusion. Hence, they decided to work out a farm plan.

Working out a farm plan

Both agreed they had too much machinery and too little livestock. Since Jones' machinery, for the most, duplicated Brown's, and since Jones preferred to have the tenant operate largely with his own machinery, Jones thought he should sell his machinery. This change was satisfactory with Brown. Jones wanted to increase the beef cow herd to 25. Brown, on the other hand, wanted to increase the swine herd and raise more corn. They reconciled their differences on the basis of what they considered the best income possibility if an owner-operator were running the farm. On this basis, they decided on 20 beef cows, 8 sows, and 10 acres more of corn than Jones had been raising. They also agreed to buy a combine jointly.

After they had decided on a production plan, their next big problem was how to share crops, livestock and expenses. Jones considered as satisfactory a 50-50 sharing of all crops and livestock, because other tenants and landlords in the area use this arrangement. However, he disliked the common practice of the landlord paying for all the fertilizer and forage seed while the tenant receives benefits from these expenses in the form of livestock products. But Brown pointed out that it was also common practice to have the tenant pay for all the hired labor while the landlord shares in the production of this labor. From surrounding rented farms, each gave additional examples of one party paying all of an expense while sharing the product with the other party. Finally, Brown suggested that they visit with a friend of his who is a tenant on a nearby farm. Brown recalled how his friend had told him about an approach for sharing products and expenses which differed from the customary but which was highly satisfactory to both tenant and landlord. Jones agreed to Brown's sug-

gestions, whereupon Brown and Jones met with Brown's friend and his landlord to learn how they shared products and expenses. The method used is outlined below in the manner that Jones and Brown put it into operation in their farming business.

Making arrangements for sharing expenses and product

Since Jones and Brown had about equal amounts of cash they first agreed to share cash expenses for production on a 50-50 basis. They next agreed to keep records of these expenses throughout the year. At the end of the year, their records appeared as follows:

	Total	Landlord	Tenant
Cash expenses for production	\$	\$	\$
Fuel and lubricants	290	145	145
Machinery repair	175	87	88
Custom work hired	300	150	150
Fertilizer	800	400	400
Spray	70	35	35
Tobacco canvas	90	45	45
Seed treatment	6	3	3
Seed, grain and tobacco	90	45	45
Seed, grass and legume for hay	340	170	170
Hired labor	230	115	115
Feed bought	250	125	125
Veterinary fees	30	15	15
Building and fence repairs	150	75	75
Total	2,821	1,410	1,411

With this record of cash production expenses before them, at the close of the year their next task was to mutually arrive at estimates of their noncash production expenses. When one estimates the contribution to production of capital items such as land, buildings, machinery and breeding livestock it is not the total value of the capital items themselves which is used. Rather it is the **annual** value of the services from these capital items, as it is the **annual** value of labor inputs, which is used. Hence, in figuring the annual value of the services of buildings and improvements, Brown and Jones used depreciation. In figuring depreciation they used this method:

$$\frac{\text{Beginning inventory value—salvage value}}{\text{Expected years of life}}$$

In computing beginning inventory values they used replacement value at beginning year's prices.

Depreciation was also used to measure the annual value of machinery services. In figuring the beginning inventory value of

machinery they used prices at the first of the year for new but similar machinery. The annual value of services from breeding sheep was measured by depreciation plus the value of estimated annual death loss. Since salvage value was estimated as equal to beginning inventory values for beef breeding stock only the value of annual death loss was used to measure the yearly value of service from such stock. For all breeding livestock, market prices at the beginning of the year were used in computing the annual value of service.

For estimating the annual contribution of land, Brown and Jones agreed to 5 percent of the total value of the 185 acres with total value based on what land like Jones' was selling for at the beginning of the year.

Jones and Brown estimated the value of nonhired labor on the basis of the year's average monthly farm wage rate in the locality. They then adjusted this rate for the management coupled with this labor.

The totals for their noncash production expenses are as follows:

	Total \$	Landlord \$	Tenant \$
Noncash expenses and contributions for production			
Depreciation or value of service			
Buildings and improvements	150	150
Machinery	424	42	382
Livestock, breeding	217	117	100
Annual contribution of land			
185 acres @ \$340 or \$62,900 x 5%	3,145	3,145
Labor and management			
Mr. Brown's 12 months	1,584	1,584
Brown's family labor, 4 months	480	480
Mr. Jones', 2 months	264	264
Total	6,264	3,718	2,546

Having figured their cash and noncash production expenses, Jones and Brown then totaled these two kinds of expenses from which they computed the proportional contributions of each. These percentages then served as the basis for sharing the product or gross income. As indicated below, Jones should receive 56 percent of the gross farm income while Brown should receive 44 percent.

	Total \$	Landlord \$	Tenant \$
Production expenses			
Cash, total	2,821	1,410	1,411
Noncash, total	6,264	3,718	2,546
Total annual contributions	9,085	5,128	3,957
Percent contributed	100	56	44

From their records Jones and Brown next figured the gross income from the year's farming operations. Of the total Jones then received 56 percent while Brown received the other 44 percent as shown below.

	Total	Shares of total to:	
		Landlord	Tenant
		56%	44%
	\$	\$	\$
Gross income			
Crops			
Tobacco	5,376	3,011	2,365
Livestock and livestock products			
Beef	2,382	1,334	1,048
Lambs and wool	1,572	880	692
Hogs	1,728	968	760
Total	11,058	6,193	4,865

Each, of course, had received a portion of the income from sales as these occurred throughout the year. Jones had received \$6,058 and Brown had received \$5,000. At the end of the year when they figured their proportional shares of the gross income, it was only a simple matter for Brown to transfer \$135 to Jones and thus bring actual receipts in line with proportional contributions.

To illustrate the sequence of steps involved in sharing expenses and product it was necessary to trace out the steps from the beginning to the end of the year. When making arrangements for sharing expenses and product as a part of the over-all lease agreement, the only arrangements which actually would be made are (1) the proportions in which cash production expenses are to be shared, and (2) that the product is to be shared in the same proportions as the proportional contribution of cash plus noncash production expenses of each party. Another item of the over-all lease agreement worked out by Jones and Brown was the duration of the agreement.

Deciding on duration of agreement

Since Brown and Jones did not know each other well they decided not to enter into a long-term agreement until they knew whether they could work together harmoniously. They therefore decided first to set up a trial period of 2 years. To give as much security to each other as possible during this trial period they further decided that the lease would automatically be renewed for another year unless one of them notified the other 6 months before

the end of the lease year that he did not wish to renew the agreement. At the end of the trial period they agreed to decide whether they desired to continue with a one-year automatically renewable lease or to establish a long-term agreement.

Compensation provisions

Jones and Brown knew that if they were going to operate the farm to yield the highest income over time, whoever makes an investment must be assured of a full return on the investment. Such assurance could come only through security of tenure. To further facilitate tenure security Jones and Brown agreed on compensation provisions for unexhausted portions of investment made by Brown, for negligence by Brown and for disturbance by either. To compensate Brown for undepreciated values of investments, such as fertilizer, lime, grass and legume seed, ponds, etc., they agreed to set up depreciation schedules at the time a particular investment is made. Knowing that no one can be expected to make an investment with assurance only of regaining the original investment, they also agreed that if Brown were to move off the farm before an investment had been fully depreciated or used up, Jones then would pay him the undepreciated value plus interest on this amount. The rate of interest they decided should be agreed upon when the investment is made.

To keep a record of investments made by Brown, he and Jones agreed to use the form below. The first item they recorded on this form was the \$1,200 combine which they had bought together. In this instance, they decided that should Brown leave before the combine was fully depreciated then Brown would receive in cash an amount equal to the undepreciated value plus interest and Jones would get full ownership of the machine.

Brown and Jones also agreed on a means for determining compensations for neglect and disturbances. For this purpose they decided on a committee of three—a person selected by Brown,

Improvement or Investment	Date To Be Completed	Percent Contribution for:			Estimated Value of Tenant's Investment	Yearly Rate of Depreciation.	Lease Year When Depreciation Begins	Interest on Undepreciated Value
		Machinery	Labor	Materials				
		T L	T L	T L				
Combine	-----	50	50		\$600	10%	1956	5%

another selected by Jones, plus a third member mutually agreed upon by the two already selected. Having agreed on length of agreement and compensations, Brown and Jones next considered the problem of whether to have a written or oral agreement.

Deciding on a written or oral agreement

Brown and Jones both realized that for most profitable farming more important than whether they had a written or oral agreement were the sharing arrangements in the agreement together with their abilities to work together harmoniously. However, both also firmly believed that by writing down what they had agreed to in conversation would contribute to a clearer understanding of the lease provisions. They felt that the clearer and fuller their understanding of the provisions, the smaller the chance of disagreements, which can lead not only to severe reductions in farm income but to additional costs to both when disagreements end up in courts. In addition, they believed that a written agreement is more effective in preventing disputes over small details than an oral agreement and that it gives more protection to their families should either of them die.

For these reasons they agreed on a written lease, which included, among others, these important items:

1. All cash production expenses are to be shared and all such expenses are to be shared in the same proportions. The proportions in which these expenses are to be shared will be determined at the beginning of each lease year on the basis of the relative amounts that each is willing and able to contribute.

2. Each party must have the opportunity of realizing full returns on any investment he makes. Accordingly, noncash production expenses shall be allocated as they are contributed. Moreover, the proportion which cash plus noncash production expenses for each party constitute of the total of such expenses shall serve as the basis for sharing the product. Current prices are to be used in figuring noncash production expenses.

3. A trial period of two years is set up to determine compatibility of the parties. During this period the lease is automatically renewable for another year unless one party notifies the other 6 months prior to the end of the lease year that he does not wish to

renew the agreement. Failure to give such notice shall be called a disturbance. At the end of the trial period, the two parties will mutually decide whether to continue with a one-year automatically renewable lease or to establish a long-term agreement.

4. Upon termination of the agreement the tenant is to be compensated for the undepreciated value of any nonremovable farm investment he has made plus interest on such value. For any investment of a removable nature and made jointly, compensation will go to the party designated to receive it at the time the investment was made. Depreciation schedules and rates of interest are to be determined for each investment at the time it is made.

5. A committee of three—a person selected by the tenant, another selected by the landlord, plus a member mutually agreed upon by the two already selected—will determine compensations for neglect or disturbance.

6. Records of cash and noncash production expenses and of investments which are necessary to carry out this lease agreement will be kept.

FARM RENTAL SITUATIONS TO WHICH THE GUIDES APPLY

In the preceding section a tenant and a landlord went through the procedure of making a leasing agreement. In this procedure, they followed the guides to more profitable share-rent farming already outlined. In this way the reader could see more clearly how the guides can be applied or used. Although the farm rental situation to which the guides were applied was one where the tenant (Brown) operated the entire farm, the guides are by no means restricted to this kind of situation. They are equally as useful on farms where the tenant shares in only a few enterprises or on farms with any other share rental situation.

Special rental arrangements on farms can be and are made which deviate from those based on the guides which have been outlined. For instance, products are sometimes shared differentially to compensate for special investments. Such special arrangements work out well on some farms. However, on more farms they do not work out. The basic reason for making them is forgotten, to later cause friction or inefficient use of resources. Leas-

ing agreements based on these guides may very well involve additional effort when compared with other leasing agreements, but such effort may yield high returns.

IMPROVING THE LEASING MARKET

Many rented farms could be operated much more efficiently, return more income to both tenants and landlords and more product to the nation's consumers if the leasing market were better organized. As the leasing market now operates, it is most difficult for the landlord to find the tenant with the kind and quantity of resources which dovetail in with his own to make the most efficient operating unit. The same can be said for tenants who are looking for farms to rent. As a result, the resources rented through the leasing market yield considerably less product than if these resources were more efficiently combined.

Efficiency of resource combinations on rented farms could be improved greatly if (1) tenants who are looking for farms to rent knew which farms were available and had information on size, productivity, buildings and other landlord furnished resources for each farm, and (2) landlords who are seeking tenants knew the tenants who are looking for farms and the kind and quantity of resources that each of these tenants can furnish. Such information needs to be made available on a local, area, and statewide basis, and could be organized and made available through the Extension Service or other agency.

