



## MINISTRY OF AGRICULTURE, FOOD AND RURAL AFFAIRS

## Lease Agreements Flexible Cash Leases

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### Introduction

Leasing and renting land is a common practice in rural Ontario. The types of rental arrangements for cropland vary widely throughout the province, as do the relationships between landlords and tenants. What is desirable or fair for one particular landlord-tenant relationship may not be acceptable for others. The purpose of this

Factsheet is to provide information to help tenants and landlords develop fair lease agreements and assist them in making sound decisions. The terms renting and leasing are used interchangeably in this Factsheet.

## **Section 1. Lease Agreements**

### **Human Components of a Successful Lease**

Any form of business agreement requires a good deal of mutual respect and trust. Leasing land is no different. To be successful, the lease arrangement must satisfy both the landlord and the tenant. Before entering into a lease, the landlord and the tenant should consider more than just price. The compatibility of the landlord and the tenant and the fairness of the lease are important aspects to consider.

#### **Checklist of a Successful Lease**

**Compatibility** - Can you get along and discuss differences? \_\_\_ yes \_\_\_ no

**Honesty** - Do you trust the person you are dealing with? Have you had business dealings together before? \_\_\_ yes \_\_\_ no

**Clarity** - Are the obligations of each party clearly defined in the written lease? \_\_\_ yes \_\_\_ no

**Equitable Terms** - Do both parties agree to the terms of the lease? \_\_\_ yes \_\_\_ no

**Flexibility** - Can you adjust the lease if changes occur? \_\_\_ yes \_\_\_ no

**Suitability** - Does the lease fit the crop and encourage good agricultural practices? \_\_\_ yes \_\_\_ no

### **Advantages and Disadvantages of Leasing Land for Agricultural Use**

There are advantages and disadvantages to all leasing arrangements.

#### **Advantages**

##### **Lower Capital Investment**

- Capital investment is shared between landlord and tenant.
- Landlord supplies land, buildings and perhaps some of the operating expenses.
- Tenant supplies labour, machinery and usually the major portion of the operating expenses.
- Operators can increase the size of their business with limited capital investment.
- Since leasing is an alternative to ownership, it is really a means of "financing" a land base.

##### **Increasing Financial Efficiency**

- When funds are limited, it is often more profitable to spend this money on seed, fertilizer, chemicals and machinery than on buying land.
- Investing scarce funds in land may severely restrict the money available for operating capital, thus lowering the efficiency of the farm business.

##### **Obtaining Farm Experience**

- Renting enables the beginning farmer to gain needed experience in the financial operation of a farm business before committing to a long-term investment in land.
- Renting enables an operator to learn more about land in an area and allows the flexibility to change farms or leave farming.
- Renting may enable an inexperienced farmer to obtain the managerial assistance or mentorship of a more experienced landlord.

##### **Sharing Risk**

- By renting, both the landlord and the tenant can share in the risks and profits of farming. This is particularly important to a farmer with limited capital. The extent of the risk-sharing depends upon the nature of the lease agreement.

## **Family Arrangements**

- A family business arrangement might include a lease agreement whereby someone rents land from a parent or rents land from a third party and shares the machinery investment with the parent.

## **Providing Retirement Income**

- A retiring farmer might consider leasing all or a portion of his or her land base rather than selling.
- Ownership of land provides a hedge against inflation.
- The income from the rent provides a form of "pension" income to live on during retirement.
- A farmer approaching retirement could gradually phase out of farming by renting a portion of his or her land and farming the rest of it.

## **Disadvantages**

### **Lack of Security of Tenure**

- Short-term leases create uncertainty for the tenant.
- Since machinery investment is matched to the land base, the cancellation of a lease could result in having machinery over capacity and a higher cost per acre.
- Short-term leases provide more flexibility for landlords since it is possible to change tenants quickly or to sell the land. However, short-term leases can work to the detriment of the landlord since they may not encourage sustainable farming practices by the tenant.

### **Lack of Efficiency, Conservation and Incentive to Make Improvements**

- Short-term leases may discourage production efficiency. For example, some tenants may not use the optimum amount of fertilizer under a crop share lease unless the landlord shares in the expense of fertilizer.
- Most soil conservation practices are a long-term investment. Most tenants with a short-term lease are interested only in practices that will show results during the term of the lease.

## **People Problems**

- As with any business venture involving two or more persons, disputes and disagreements can arise.

## **Availability of Credit**

The tenant farmer usually has a more difficult time obtaining intermediate and long-term credit than does the owner-operator because:

- the lender may require land as security for the loan
- leased land does not build equity
- the lease is short term

## **Lack of Bargaining Power and Managerial Control**

- There may be situations where the landlord has greater bargaining power even though the tenant is a capable manager.
- The landlord may insist on making most of the management decisions even though his or her contributions to the lease may be substantially less than the tenant's. For example, the landlord may insist on certain crops being grown that the tenant feels are not the most profitable.

## Lost Opportunity for Capital Gain

- Land prices have generally increased over time, although they do decline occasionally.
- Land appreciation is an added benefit to the landowner, even though the capital gain is not realized until the property is sold.

## Potential Loss of Tax Deferral or Exemption

- Leasing land can in some cases prevent the use of both the tax-deferred transfer to children and the \$1,000,000 capital gains exemption (the exemption increased to \$1,000,000 in 2015, and will be indexed for inflation starting in 2015).
- Consult an accountant.
- See [Section 2. Tax Implications of Land Leases](#).

## A Written Lease Agreement

The most important thing you can do as a tenant or landlord is to put your agreement in writing. This one action would eliminate the vast majority of disagreements that occur. Even though the handshake has been a long-standing method of doing business in the rural community and a verbal lease agreement is a valid contract, it has serious disadvantages. However, many farmers and landowners are reluctant to use a written lease for several reasons:

- Tenants and landowners alike do not want to give the impression that they distrust their neighbours by requiring a written lease.
- The added time and cost to prepare a written lease may not seem justified when dealing with other farmers or community members.

The disadvantage of a verbal lease becomes apparent when a disagreement about the terms of the lease occurs, because it is exceedingly difficult to prove what the original understanding between the parties was.

Without a written agreement:

- settling a misunderstanding between the parties once the land is in use (through mediation by a third party, arbitration or litigation) can be extremely costly
- it is more difficult to protect the interests of both parties against any claims of a third or outside party to a right to the land or the crop - it is much easier to protect your interests from third-party claims by documenting the details of the agreement at the time you enter into it
- the risk of losing significant time and business goodwill is high for both landowner and the lessee

A written agreement is not a sign of distrust - it shows that both parties want to protect and clearly document the agreement they are making.

## Advantages of a Written Lease Agreement

Under the Ontario Statute of Frauds, all documents that create an interest in land must be in writing. A written lease is advantageous to both the landlord and the tenant since it provides both with a record of what they have agreed to. In the case of crop share leases, where the landlord and tenant are sharing costs, this is especially important. A written lease:

- clarifies the expectations, obligations and responsibilities of both parties. If a dispute occurs, a written lease can prevent costly legal action by providing for alternatives to a court proceeding
- gives the landlord some protection in the event of an environmental liability
- provides a valuable guide to heirs if the landlord or tenant should die
- provides documentation for tax purposes

## What to Consider Before Entering into a Lease Agreement

**Insurance** - Landowners may consider requesting proof of crop insurance, especially if the rent has not been prepaid. The tenant and landlord should also discuss insurance for protection from any potential environmental damage. If the tenant plans on storing any harvested crop on the landowner's property, there should also be insurance provisions for protection from theft or damage.

**Securing the lease payment** - Registering any unpaid portion of the lease payment with ServiceOntario under the Personal Property Security Registration will help protect a landowner's interest as a creditor in the event of non-payment by a tenant. Landowners may register online or by calling ServiceOntario.

A tenant may also want to have the lease registered against the title to be protected in the event that the land changes ownership. There may be very good reasons to consider the registration of the lease: for instance, any payments relating to the real estate can, in some instances, be considered "personal property" and fall within the registration provisions of the Personal Property Security Act; any interest in those payments would be subordinate to any other interest by way of a lease, so long as the lease is registered first.

Most properties in Ontario are registered under the Land Titles system, which dictates that leases for a period not exceeding 3 years do not require registration where the tenant is in actual possession of the property described in the lease. For properties under the less popular Land Registry system, the period is increased to 7 years. In the absence of registration, a subsequent purchaser of the land could take ownership without having to honour the terms of the lease.

**Title search** - Tenants may also perform a search on the title of the land to be leased to make sure they are entering into an agreement with the person who is the owner of the land. A title search may be done through the Ontario Land Registry Office.

## A Lease Agreement as a Succession Planning Tool

A long-term lease agreement (not to be confused with a sale and leaseback arrangement) may be used as a succession planning tool. Landowners and potential farm successors thinking about alternatives to traditional financing options might want to consider a long-term leasing arrangement. Lease arrangements may include land, buildings and/or equipment. Owners and successors may choose to have multiple lease arrangements or a single inclusive lease. Leases in Ontario can be of any length of maturity, however, leases longer than 21 years must have the approval of the municipality to be valid.

Like any lease, the terms must be negotiated to the satisfaction of both parties. One of the biggest difficulties after setting the initial lease payment amount is determining what the annual increase should be. For longer-term leases, an impartial setting, such as the annualized core Consumer Price Index, which is published by Statistics Canada, may be used. It is advisable to talk to a succession planning professional to help set out some of these terms.

## Section 2. Tax Implications of Land Leases

The following is for general illustrative and information purposes only and is not comprehensive, nor is it intended to be legal advice. It does not replace professional advice from a tax specialist. Remember, tax laws and qualifications for programs may be time limited or may change. It is strongly recommended that you consult with a tax specialist for up-to-date advice that is specific to your agreement.

The tax implications of entering into a lease agreement should be carefully considered.

Landlords can inadvertently disqualify themselves from being able to use two major tax provisions. The Canada Revenue Agency (CRA) does not consider many types of leasing to be farming. For example, a share crop lease, where a portion of the crop is given to the landowner as payment for the land, may not meet the CRA's definition of farming. As a result, some leasing arrangements can disqualify landowners from using the following tax provisions:

- the ability to use a tax-deferred rollover on the transfer of land to children (called a rollover)
- the \$1,000,000 capital gains exemption on their land

## Tax Deferred Rollover to Children

The Income Tax Act allows for the transfer of farmland to a child on a tax-deferred basis. This is accomplished by using what is called a "rollover." It allows the transfer price to be set at any value between zero (a gift) and the fair market value (FMV) of the land. In the case of a gift, the transfer value would be the adjusted cost base (ACB). Without the use of the rollover, the land would have to transfer at its FMV and all the gain would have to be reported.

To qualify for the rollover, the property must have been used principally in the business of farming prior to the transfer by the taxpayer, the taxpayer's spouse or their children who were actively and continuously involved. This means that the land's use was farming for greater than 50% of the time (as defined by the CRA). The property does not, however, have to be used in farming immediately before a transfer takes place in order to qualify for the rollover.

Landowners who want to use the rollover should monitor the percentage of time that they have leased their land and what type of leasing arrangement they are using. For example, a landowner who farmed a property for 20 years, then leased the land for 4 years could still qualify for the rollover. If, however, the leasing period was longer than the farming period, it could disqualify the use of the rollover. An exception to this is if the person leasing the property is the landowner's spouse or child actively engaged in farming.

## **The \$1,000,000 Capital Gains Exemption**

### **Selling Farmland**

The \$1,000,000 capital gains exemption is available to individuals on the sale of qualified farm property. Individuals who had used their entire \$100,000 personal exemption, which was eliminated in 1994, have \$900,000 remaining. The exemption is also available for partners in a partnership, since taxes are paid at the individual level. However, corporations do not have any capital gains exemption.

Qualified farm property includes:

- farm land and buildings
- shares in a family farm corporation
- an interest in a family farm partnership
- quota (referred to as eligible capital property)

Qualified farm property must meet the following definitions:

- property purchased before June 18, 1987, must be used in farming at the time of sale, or have been used in farming for any 5 years during its ownership
- property purchased after June 17, 1987, must be owned for 24 months prior to the sale, and in at least 2 years, the gross farm income must exceed net income from other sources or the property was used by a family farm partnership or corporation in a 2-year period during which time the individual, spouse, child or parent was actively involved in the farming business

In either of the above cases, property must be used in farming by:

- the individual
- the spouse, child or parent of the individual, or
- a family farm partnership or corporation of the individual, spouse, child or parent

In all cases, the qualifying individuals, whether farming as a sole proprietorship, a partnership or as a shareholder in a farming corporation, must be actively engaged in management and/or the day-to-day activities of the business.

### **Leasing Farmland**

Leasing farmland is most likely to affect the use of the exemption on land purchased before June 18, 1987.

Land purchased before June 18, 1987, must be farmed for any 5 years or farmed in the year of sale to be considered qualified farm property and therefore eligible for the capital gains exemption. If the 5-year rule has not been met, the property must be farmed immediately before the sale.

Since leasing is not considered to be farming, according to the Canada Revenue Agency (CRA), a lease in the year of sale could disqualify the landowner from using the capital gains exemption because it was not farmed immediately before the sale. Even a share crop lease, where a portion of the crop is given to the landowner as payment for the land, does not meet the definition.

Hiring custom operators to do the cropping work may solve this problem. Alternately, a share crop lease where the landowner is sharing the cost of inputs may also meet the CRA requirements of farming. Discuss such agreements with your accountant.

### **Canada Pension Plan and Registered Retirement Savings Plan**

Rental income from a cash lease cannot be used as a basis for contributions to the Canada Pension Plan (CPP). Farmers who lease their land and have no other CPP-eligible income source will be unable to make contributions to the plan. This may have the effect of reducing the amount of CPP pension benefits. Although rental income is not eligible for contributions to the CPP, it is considered earned income for the purpose of contributions to a Registered Retirement Savings Plan (RRSP).

Rather than operating under a cash lease, a landowner could farm the property by hiring custom operators or lease the land on a crop share basis where the inputs are shared. Currently, the net income from these sources is eligible for contributions for both the CPP and RRSPs.

### **Non-Resident Withholding Tax**

If the landlord is a non-resident of Canada, the tenant is required to withhold 25% of the rent (cash rental or crop share) and submit it to the Canada Revenue Agency (CRA). If the tenant does not remit the 25% withholding tax, the CRA will attempt to collect the tax from the landlord. If the landlord does not pay this tax, the tenant will be liable for the payment.

### **Capital Cost Allowance**

When a landowner changes the use of the farm land, buildings or machinery, such as in renting, the Income Tax Act requires that the depreciable assets purchased before 1972 (Part XVII) be switched from the Straight Line Method of capital cost allowance to the Declining Balance Method, which is used for depreciable assets purchased after 1971 (Part XI).

In most cases, this is undesirable, since it would mean that all recaptured capital cost allowance that occurs when the class is closed out (e.g., sale of all machinery in that class) would be taxable income. The landlord could choose to not use the property and still maintain the Part XVII status, however, no deduction could be claimed in the years when it was not used. Any other use, either personal or rental, would require a change to Part XI. The landlord could choose to use his machinery or buildings as part of a custom farming arrangement and thereby maintain the farming status.

### **Harmonized Sales Tax (HST)**

Generally speaking, a lease is taxable unless specifically exempted under Part I of Schedule V of the Excise Tax Act, which might apply in limited situations such as land destined as long-term residence. Rent that is paid by way of share of the crop is not subject to the HST. The treatment of cash rents for HST purposes may also depend on the landlord's total income. A business (including a landlord who rents property) does not have to register to collect and remit HST if its gross taxable and zero-rated sales are under \$30,000. Landlords whose only source of business income is rent, where the rental income is less than \$30,000, need not register, although they may choose to do so.

### **Farm Property Class Tax Rate Program**

The Farm Property Class Tax Rate program enables eligible farm properties to be taxed at 25% of the municipal residential/farm tax rate. The farm residence and 1 acre of land surrounding it are taxed as part of the residential class.

To be eligible for the reduced rate, an application to the program must be filed showing that the property is used by a farming business with gross farm income of \$7,000 or more which has a valid Farm Business Registration number. Exceptions to this threshold can be made for new farming operations. For more information, contact the ministry toll free at 1-877-424-1300 or visit the website at [www.ontario.ca/farmtax](http://www.ontario.ca/farmtax).

## **Section 3. Elements of a Lease Agreement**

### **The Components of a Lease Agreement**

A written lease can be as simple or detailed as the landlord and the tenant wish. The following summary presents the items that a lease can contain, categorized under three headings.

### **Items in Written Lease Agreements**

#### **Required Items**

- names and addresses of tenant and landlord
- description of property to be rented
- term and renewal of the lease
- rent payable payment and use of utilities

#### **Recommended Items**

- right of inspection and removal of crops
- transfer of property
- termination of the lease
- use of the land
- environmental matters
- insurance
- rights to assign or sublet the lease
- resolution of differences
- restrictions of land use

#### **Optional Items**

- production practices and management decisions
- income support payments, subsidies and reimbursements
- repairs to buildings, fences and improvements
- duty to notify AGRICORP
- compensation for property damages
- rights of first refusal
- option to purchase
- municipal zoning restrictions

#### **Required items**

All leases must contain this information:

**Names and addresses of the tenant and landlord** - Including spouses if required.

**Description of property to be rented** - Includes the legal description and specifies buildings or areas to be excluded.

**Term of the lease** - Indicates when it starts and how long it lasts. Although not a basic requirement of a lease, this section should also address the renewal of the lease if the parties wish to maintain the lease agreement for a period of years, including when and how such a renewal will take place.

**Rent payable** - The amount of rent, how it is calculated and when it is to be paid. In the case of a building lease or where the renter has access to facilities, the payment and use of utilities should also be stipulated.

#### **Recommended items**

Items that every landlord and tenant should consider including in the lease agreement:



**Right of inspection and removal of crops** - Includes the following:

- The landlord should have the right at all times to inspect the rented property.
- The tenant should be able to complete harvesting of the crop after a reasonable time period after the termination of the lease agreement or the sale of the property. If this is not possible, the landlord will compensate the tenant for the anticipated agreed value of the crop.
- The incoming tenant, purchaser or landlord should have the right to enter on the land after harvest in the last year of the agreement to prepare the land for next year's crop.

**Transfer of property** - It is important that the landlord and tenant discuss their expectations in the event that the landlord sells the farm property to a new owner during the term of the lease. A fair agreement will attempt to strike a balance between the landlord's desire to not unduly restrict his or her ability to sell the farm and the tenant's desire to continue the lease arrangement.

**Termination of the lease** - The lease should clearly spell out how it can be terminated. This could be due to a breach of the terms of the lease or merely because the termination date of the lease has arrived.

**Use of the land** - The lease should state how the tenant is going to use the land. The lease should also describe any certification, regulatory or contractual constraints that the renter should be aware of, such as the land being certified as organic. The tenant should be required to adhere to normal farming practices in regard to disposal of manure. It should also be clearly stated how the land is to be left after termination of the lease. If buildings are included in the leased property, the lease should state how the buildings will be used and the rules for accessing the buildings.

If the farm will be used for selling products such as pick your own fruit, the lease should indicate this, and the tenant should be made aware of all the regulations governing the sale of food products, in addition to food safety requirements.

**Environmental matters** - This clause addresses the issue of environmental policies and responsibilities. In the event of an environmental problem, landlords, as owners of the lands, are ultimately responsible for activities occurring on their land. The tenant, as "user" of the land, should agree to adhere to appropriate and accepted farm practices and legislation relating to the environment (manure disposal, pesticide and herbicide applications, etc.). The tenant should also provide a "warranty" - a legal term meaning that this assurance can be legally relied upon - that they possess the necessary provincial licences for the application of pesticides or other chemicals to be used on the property.

Normally the tenant bears the cost, including the costs associated with an environmental clean-up, and reimburses the landlord for any costs that the landlord incurs as a result of the breach by the tenant of any environmental regulation.

**Insurance** - A clause regarding insurance would allow the landlord and tenant to identify who will be responsible for insurance coverage. The parties should ensure that adequate policies of insurance coverage, including occupier's liability insurance (insurance against personal injuries sustained by people coming onto the farm property) and fire insurance (especially if buildings are included), are in place.

**Rights to assign or sublet the lease** - The written agreement should contain a clause that prevents the tenant from subletting or assigning the lease to another individual without the written consent of the landlord. In a production lease, the consent of the landlord can be withheld at the landlord's sole discretion, without explanation or reasonable cause (i.e., unreasonably withholding consent). In the case of a residence, the landlord cannot unreasonably withhold consent.

**Resolution of differences** - An arbitration or mediation clause in the written agreement describes how to deal with disagreements the tenant and landlord cannot resolve. The most common practice is to appoint a mutually agreed upon third party to act as a mediator or arbitrator.

**Restrictions of land use** - The lease should clearly define any areas that may have restricted use (e.g., the area directly underneath a wind turbine).

**Optional Items**

These items add clarity to the lease agreement and provide discussion points for the landlord and tenant as they formulate the lease agreement:

**Production practices and management decisions** - This clause deals with production and management decisions the landlord wants carried out by the tenant. Some of those factors could include:

- cropping decisions
- proper use of fertilizer and chemicals
- crop insurance and revenue insurance
- delivery and sale of crop

**Income support payments, subsidies, reimbursements** - The written agreement should clearly specify how government or marketing agency payments will be divided. This is most relevant in a crop share lease.

**Repairs to buildings, fences and improvements** - A clause stating who is responsible for repairing buildings, fences and other improvements, and how the expenses will be shared. A common practice is to have the tenant responsible for all minor repairs and for the landlord to reimburse the tenant for improvement costs that have a lasting benefit longer than the rental term.

Examples of major improvements that extend beyond the length or termination of the lease are:

- building and fence construction
- erosion control
- tile drainage
- clearing land

It is usually required that tenants obtain written permission from the landlord before making major improvements. It is also important to outline how the value of improvements will be determined and when compensation will be made. An example of one form of compensation to the tenant for improvements is for the landlord to let the tenant farm the improved land rent-free for a specific period of time to be agreed upon between the parties (in writing) at the time the improvement is consented to by the landowner. An annual review and agreement of the repairs and improvements needed could also be included here.

**Duty to notify AGRICORP** - Both the landlord and tenant must notify AGRICORP of any crop-sharing arrangement.

**Compensation for property damages** - This clause is especially necessary for determining responsibility for third-party and environmental damages.

**Rights of first refusal** - In some cases, the tenant is interested in purchasing the leased land but is either unwilling or unable to do so at the time. In these cases, the landlord may be willing to include an option whereby the landowner will notify the tenant that there is an offer to purchase from another party, allowing the tenant to bid on the purchase of the land before the landowner accepts the offer to purchase the land from the other party.

**Option to purchase** - The parties may include an option similar to the right of first refusal that allows the tenant to purchase the leased lands. This could be for a limited or unlimited time and for either a fixed price or a price to be determined by some objective method such as a real estate appraisal by a certified agricultural appraiser.

**Miscellaneous** - The lease agreement may contain a clause that would terminate the lease if certain natural disasters occurred. For example, if the land were flooded and the tenant were unable to use the property, it would be unfair to insist the tenant continue to pay the cash rental unless the original rent charged had considered the risk of flooding. Other unforeseen circumstances include the installation of a highway, gas line, oil well sites, etc., on the rented land, creating inconvenience and additional operating costs for the tenant. In some instances, instead of terminating the lease, it may be considered desirable to renegotiate the terms of the lease or compensate the tenant for the added costs or reduced income they may incur.

**Municipal zoning restrictions** - The tenant enters into a farm lease with the express intention of conducting agricultural operations; it is important that the landlord provide an assurance to the tenant that the lands are properly zoned for such use. If the landlord is unwilling to provide such a warranty, the tenant should get

advice from the local municipal authorities to ensure that the purpose to which the tenant wishes to put the property is permitted.

## **Section 4. Developing a Flexible Cash Lease Arrangement**

### **Flexible Cash Lease Arrangements**

Since farm commodity prices and crop production costs may fluctuate widely from year to year, tenants and landlords may not want to commit themselves to a fixed cash rent for more than 1 year. Tenants are concerned that fixed cash rent could create a financial hardship if prices drop or if poor growing conditions reduce yields. Landlords may think it is unfair for the tenant to reap all the benefits of a sharp rise in crop prices or yields. At the same time, neither party wants a crop share leasing arrangement.

In these cases, a flexible cash lease arrangement may help a tenant and landlord reach an agreement that addresses both their concerns

### **Advantages and Disadvantages of Flexible Cash Leases**

#### **Advantages**

- The tenant may reduce the financial risk if the cash rent is adjusted down when crop prices or yields are below normal.
- Less communication and joint decision-making may be required than would be typical in a crop share lease.
- Cash rates tend to be set by the previous year's prices. Flexible rent is based on the current year's prices.
- A well-designed flexible lease may reduce the need for frequent re-negotiation of cash lease levels.
- Flexible cash rent enables the landlord to share in the additional income that results from above-average prices, yields or both.

#### **Disadvantages**

- Flexible cash leases may increase the financial risk for the landlord.
- If the rent adjustment involves yield, the landlord may need to trust the tenant to accurately measure the production.
- Calculating flexible cash leases may be more difficult, especially on lands that have multiple crop

### **Establishing a Rental Price**

A flexible cash lease rental price may be arrived at by adjusting for:

- crop price
- crop yield
- crop price and crop yield (gross margin)

In general, each method of adjusting the rental amount uses the same two concepts to arrive at a cash rental amount:

- The yield or price is set in advance and the cash rent is calculated by multiplying the harvest price or yield.
- A base price is set and an adjustment is made based on the price, yield or gross margin. These adjustments can be as simple or complex as the parties wish to make them.

### **Methods of Determining Flexibility**

There is an almost unlimited number of ways to make your lease agreement flexible. The following section outlines just some of the methods you can use, giving example calculations.

### **Adjusting for Crop Price**

Adjusting for price means that only the crop price, not the yield, affects the cash rental rate. From a tenant's point of view, this arrangement would not be advised if the land was prone to widely variable yields, since low yields would not adjust the cash rent downward. The tenant in this case would be exposed to production risk.

This type of agreement should have a method of pricing the crop at harvest. For example, the price could be the average daily price of the crop from November 1 to December 1 as quoted by three local elevators. The landlord and tenant may also wish to consider a maximum and minimum amount of rent for those years of low yields and/or unusually high prices. In addition to this, the tenant and landlord may decide how they are going to handle government support payments such as Market Revenue and if they will be included in the price determination formula.

### **Fixed Amount of Commodity**

- rent is valued at a set quantity or yield
- price is calculated using a local elevator or crop insurance rate

### **Example Calculation**

Rent  
 = 1.875 metric tonne/ha x \$200  
 = \$375/ha

As price changes, so does the rental rate.

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### **Base Rent + a Set Number of Metric Tonnes Priced at Harvest**

- a base rent paid, regardless of yield
- additional rent based on the price of a set number of metric tonnes of crop at harvest

### **Example Calculation**

Rent  
 = \$400 + (0.3 metric tonne x price at harvest)  
 = \$400 + (0.3 x \$200)  
 = \$400 + \$60  
 = \$460/ha

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### **Base Rent Varies with Base Price**

- the base rent and base price of the crop are determined at the beginning of the lease
- the harvest price is used in the final calculation to adjust the cash rental rate
- the agreement would specify a method of determining the current year's price

### **Example Calculation**

Base rent = \$375/ha  
 Base price = \$160/metric tonne  
 Current year's price = \$200  
 Rent  
 = \$375 x (\$200 (current price) ÷ \$160 (base price))  
 = \$375 x 1.25  
 = \$468.75/ha

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### **Base Rent with Adjustments for Prices Outside a Specified Range**

- the base rent and the price range that the base rent applies to are established

- when the current year's price moves outside of that range, the base price is adjusted based on a predetermined formula

### Example Calculation

Base rent = \$375/ha

Price range = \$240 to \$160

Current year's price = \$248

Adjustment (for each \$4 price change in price, the rent would change by \$12/ha)

=  $(\$248 - \$240) \div 4$

= 2

Rent

=  $\$375 + (2 \times \$12)$

= \$399/ha

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### Minimum Base Rent with Upward Adjustments

- a base rent is adjusted upward if the crop price at harvest rises above a predetermined level

### Example Calculation

Base rent = \$375/ha

Current year's price = \$200

Adjustment (for each \$4 rise in price above \$188)

= \$12/ha

Rent

=  $\$375 + ((\$200 - \$188) \div \$4) \times \$12$

=  $\$375 + (3 \times \$12)$

= \$411/ha

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### Adjusting for Crop Yield

Adjusting for yield only can be done several ways. This type of agreement should have a mechanism for measuring the yield of the crop.

### Percentage of Crop

- rent is paid based on a percentage of the crop at a predetermined price

### Example Calculation

Yield = 8.1 metric tonnes

Percentage = 30%

Pre-determined price = \$200

Rent

=  $8.1 \text{ metric tonnes} \times 0.30 \times \$200$

= \$486/ha

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### Fixed Payment per Metric Tonne

- rent is calculated using a fixed price per unit of crop harvested

### Example Calculation

Fixed payment per metric tonne = \$40

Yield: 8.75 metric tonnes

Rent = \$350/ha

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### Base Rent + a Fixed Rate for Each Metric Tonne Over a Minimum Yield

- base rent is fixed
- a fixed rate per metric tonne is made for yields above the predetermined minimum yield

### Example Calculation

Base rent = \$250/ha

Minimum yield = 7.5 metric tonnes

Actual yield = 9.4 metric tonnes

Fixed rate for yields above the minimum

= \$32/metric tonne

Rent

= \$250 + ((9.4 - 7.5) x 32)

= \$310.80/ha

### Landlord Takes Delivery of a Percentage of the Crop

- landlord makes arrangements with the tenant and a local elevator to have a percentage of the crop registered in his name
- elevator deducts and remits any marketing fees
- landlord markets crop

Note: this is sometimes referred to as a crop share lease but is not in the true sense. See the OMAFRA Factsheet, [Lease Agreements - Crop Share Leases](#).

### Example Calculation

Percentage of crop = 30%

Yield = 9.4 metric tonnes

Landlord takes delivery of 9.4 x 0.30

= 2.82 metric tonnes/ha

### Adjusting for Crop Price and Yield (Gross Income)

If a landlord and tenant want to share both the price and the yield risk associated with a crop, they do so using these methods.

#### Percentage of the Crop

- the most common type
- rent is based on a percentage of the crop
- price is established at harvest

### Example Calculation

Percentage of crop = 30%

Price of crop at harvest = \$200

Yield = 8.75 metric tonnes

Rent

= 0.30 x 8.75 x \$200

= \$525/ha

### Base Price with Adjustments for Yield and Price

- a base rent, price and yield are established
- the actual price and yield are then used to adjust the base rent

### Example Calculation

Base rent = \$250/ha  
 Base yield = 7.5 metric tonnes  
 Base price = \$200/metric tonne  
 Actual yield = 8.13 metric tonnes  
 Actual price = \$208/metric tonne

Rent

= \$250 x (8.13 (act. yield) ÷ 7.5 (base yield) x (\$208 (act. price) ÷ \$200 (base price))  
 = \$250 x 1.08 x 1.04  
 = \$280.80/ha

### Base Rent Tied to Gross Income

- a base rent is established
- adjustments are made to the base rent based on the amount of gross income from the crop above an established level, e.g., \$0.50 for every \$1 over \$400 of gross

### Example Calculation

Base rent = \$250/ha  
 Actual yield = 10 metric tonnes  
 Actual price = \$200/metric tonne  
 Minimum gross = \$1,500/ha  
 Actual gross value = 10 x \$200 = \$2,000  
 Rent  
 = \$250 + ((\$2,000 - \$1,500) x .50)  
 = \$250 + (\$500 x .50)  
 = \$250 + \$250  
 = \$500/ha

**Table 1.** Net revenue after rent payment - landlord's position

Price per metric tonne	Base Rent with an Adjustment for the Price (metric tonnes/ha)			
	2.3	2.7	3.1	3.5
\$351.85	210.02	210.02	210.02	210.02
\$370.00	250.00	250.00	250.00	250.00
\$388.89	291.63	291.61	291.61	291.61
\$407.41	332.40	332.40	332.40	332.40
\$425.93	373.19	373.19	373.19	373.19

Price per metric tonne	Base Rent with an Adjustment for the Yield (metric tonnes/ha)			
	2.3	2.7	3.1	3.5
\$351.85	102.00	250.00	398.00	546.00
\$370.00	102.00	250.00	398.00	546.00
\$388.89	102.00	250.00	398.00	546.00
\$407.41	102.00	250.00	398.00	546.00
\$425.93	102.00	250.00	398.00	546.00

Price per metric tonne	Base Rent with an Adjustment for Price and Yield (Gross Value) (metric tonnes/ha)			
	2.3	2.7	3.1	3.5

\$351.85	186.75	233.67	280.58	327.49
\$370.00	200.67	250.00	299.33	348.67
\$388.89	215.15	267.00	318.85	370.70
\$407.41	229.35	283.67	337.99	392.31
\$425.93	243.54	300.33	357.12	413.91

**Table 2.** Net revenue after rent payment - tenant's position

Price per metric tonne	Base Rent with an Adjustment for the Price (metric tonnes/ha)			
	2.3	2.7	3.1	3.5
\$351.85	597.48	739.98	882.48	1,024.98
\$370.00	600.00	750.00	900.00	1,050.00
\$388.89	600.89	758.39	915.89	1,073.39
\$407.41	602.60	767.60	932.60	1,097.60
\$425.93	604.31	776.81	949.31	1,121.81

Price per metric tonne	Base Rent with an Adjustment for the Yield (metric tonnes/ha)			
	2.3	2.7	3.1	3.5
\$351.85	705.50	700.00	694.50	689.00
\$370.00	748.00	750.00	752.00	754.00
\$388.89	790.50	800.00	809.50	819.00
\$407.41	833.00	850.00	867.00	884.00
\$425.93	875.50	900.00	924.50	949.00

Price per metric tonne	Base Rent with an Adjustment for Price and Yield (Gross Value) (metric tonnes/ha)			
	2.3	2.7	3.1	3.5
\$351.85	620.75	716.34	811.92	907.51
\$370.00	649.33	750.00	850.67	951.33
\$388.89	677.35	783.00	888.65	994.30
\$407.41	705.65	816.33	927.01	1,037.69
\$425.93	733.96	849.67	965.38	1,081.09

### Comparing the Methods of Adjusting

It is important that the landlord and tenant consider the possible outcomes of the flexing method they are using. Tables 1 and 2 outline the three methods and show the results for both the landlord and tenant, respectively.

In each of the scenarios, the base rent was set at \$250/ha. In a real-life situation, the landlord and tenant would attempt to choose a base price that was close to the average rent in the area or slightly below. This would be the desired rental rate in an average year. In the examples here, the average yield was 2.7 metric tonnes/ha, and the average price was \$370. These prices and yields are only examples.

Each landlord and tenant should determine the averages they want to use, based on their individual situation.

### Establishing a Price and Yield

The method of establishing both price and yield should be clearly spelled out in the written agreement. The tenant and landlord should clarify the following issues:



- How is yield going to be measured? Will it be by volume in storage at the close of harvest, total weight or harvested samples?
- Will adjustments be made for moisture?
- If volume is used as the measure, when is it measured and is test weight being considered?
- How will the price be established? Will it include government support payments?

## Resources

Knowing your costs is important in determining a fair rental rate and developing a lease agreement. Your own records are the best source of this information, however, when these are not available it is important to use realistic estimates. OMAFRA Publication 60, Field Crop Budgets, is updated annually. The crop budgets can provide you with cost estimates for comparison.

## Summary

One major purpose of a flexible lease agreement is to reduce the tenant's risk. In exchange, the landlord shares in some added return if the yield or price increases. Both the landlord and the tenant should test their method of adjusting rent by using various crop yields and price scenarios. This will assure that the agreement does not place undue hardship upon either the landlord or tenant. As in all crop lease situations, the tenant should estimate the cost of producing each crop closely before negotiating the lease. In addition, flexible leases do not adjust for unexpected changes in the cost of purchased inputs. Consequently, flexible rents should be re-examined periodically and adjusted in response to changing input costs.

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