An important problem:

Keeping Leases Up to Date

Unless we take time to "check up" once in awhile, we find our leases failing to do the job intended—leading to dissatisfactions, disagreements and terminations. This article points up some of the problems that need attention.

by Walter E. Chryst and John F. Timmons

LOCAL customs have a big influence on farm rents—whether cash, share or a cash and share combination. But "custom" tends to resist change. Farm rents become "sticky" and lag behind changes in farm prices, costs and production. As a result, farm rents vary widely in relation to net farm returns. The consequences are often dissatisfaction, disagreement or termination of rental agreements.

To avoid these difficulties, landlords and tenants frequently are looking for ways and means to keep their rents up to date with changing economic conditions. To provide some help, we've studied the effects of changes in the costs of items farm operators buy, changes in prices received and changes in production. And we talked about rent adjustment problems with landlords and tenants throughout the state. They explained how they were trying to work out rental adjustments for cost, price and production changes.

Rent, Net Returns . . .

Here are some of the things we found which may be helpful in your own individual situation.

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To find out what effects price, cost and production changes have on rents, we analyzed the farm records of tenants and landlords cooperating in the Iowa Farm Business Associations. We looked for the division of net income between landlord and tenant and expressed this division as a ratio of the landlord's net to total net farm income. We called this the "net return ratio" and found it from these records for the period from 1926 through 1953—a period having many important price, cost and production changes. And these changes, in turn, are reflected in the net return ratio.

Table 1 shows how the landlords' share of net farm income has varied through this period under cash, crop-share and livestock-share leases. The tenants' share, of course, varied in the opposite direction. That is, when the landlords' share was "up," the tenants' share was "down" and *vice versa*.

Note in table 1 that: (1) There were wide differences in the net return ratio for all three kinds of rent. (2) The amount of the differences varied with the kind of rent. (3) The ratio sometimes went in different directions during the same year, depending on type of rent.

Notice the range of the net return ratios. The extreme variation of the division of net returns under cash rent is indicated by the landlords' share of net returns being three times greater in 1930 than it was in 1926, for example. At the same time, the tenants' share was less than half as much in 1930 as in 1926. And, in 1942-43, the landlords' share of net farm income was only about half as much as in 1926. At present, cash rents yield a net return about three-quarters as large as in 1926, 1935 or 1948.

Prices generally have been rising since 1933. That cash rents have failed to keep pace with price changes is indicated by the downward trend in the return ratio during the 1933-53 period. In only 2 years, 1937 and 1938, of the 21-year period has the ratio risen above the 1933 level.

The net return ratio has also varied widely under the crop-share rent. In 1931 the ratio was more than seven times as high as in 1926; only 3 years later, in 1934, the ratio was two-thirds of its 1926 level. As was true for the cash-rent ratio in 1932, the crop-share net return ratio was negative in this year—indicating that the landlords' net returns exceeded the net return of the farm.

At present the landlords' net return ratio is about three-fifths more than in 1926. But the trend in the ratio is the opposite of the cash-rent trend. The crop-share trend is upward, with only 2 years in the 1933-53 period showing a net return ratio less than that of 1933.

As measured by the difference in range, the ratio of net rent to net farm income under livestock-share rent had less variation than either cash or crop-share rent over the total period covered. The trend, however, has been upward.

Point Up Problem . . .

These variations within and between kinds of rent point up the problem faced by landlords and tenants in trying to reduce variations of net rent in relation to net farm income. The findings also help explain the trends in kinds of rent paid in Iowa as reported by the Census (see table 2). Cash leases have declined from 56 percent of all leases in 1900 to only 17 percent in 1950. Share renting has increased. In 1950, 77 percent of all tenants paid at least part of their rent in shares of crops or livestock.

The trend away from cash rent can be explained at least partly by the dissatisfaction of tenants with the year-to-year variation in division of income, and landlords haven't liked the general downward trend in their share of the division. In essence, the shift from cash to share renting is a method of getting more flexibility into the rental agreement.

Along with the trend away from cash rents and to share rents is another trend — that of supplemental cash payments over and above shares of crops. This trend has grown from 17 percent in 1910 to 46 percent in 1950. There's another trend not so obvious from census data—a shift away from crop-share to livestock-share rent. Livestock-share rent accounted for 24 percent of all tenants in 1950 and is included in the 31 percent paying "shares only." This leaves only 7 percent of the tenants paying only shares of crops as rent in 1950.

Why Variations?

Table 1 indicated the size and type of problems we face in division of net returns. Table 2 indicated the shifts in kinds of rents made by landlords and tenants in attempts to answer the problems. Before considering other things that might be done, let's take a look at some possible explanations of the variations in rents in relation to farm incomes. The explanations seem to rest in five major factors:

- Amounts and shares of rents become relatively fixed by local customs and resist changes needed to keep pace with price, cost and production changes.
- Landlords and tenants contribute different kinds of resources and sometimes different amounts of the same resources. Thus, changes in costs and prices have different effects on their relative shares of income over time.
- Extending rental terms over a period of years — even though the lease may be renewed each year—causes the rent to fail to reflect farm income changes growing out of changes in prices, costs and production. This is especially true in the case of cash leases.
- It's not possible to predict future prices, costs and production at the beginning of a lease. But these will have an important bearing on the shares of net farm income either party will receive.
- Laws relating to liens tend to reinforce inflexibilities in rental arrangements beyond the period for which a particular rent is to be paid.

Adjustments Made . . .

We interviewed 90 landlords and tenants to find out what kind of adjustments they have made to take care of excessive variations in rent. All farms were included in the Farm Business Associations, and records of income changes were available to study in connection with the adjustments made.

These landlords and tenants made 165 individual "solutions" growing out of rent inflexibilities since 1939. Some appeared successful, but many were unnecessary in the sense of being avoidable through lease adjustment. We

TABLE 1. Indexes of Proportions Landlords' Rent Is of Net Farm Returns for Cash, Crop-Share and Livestock-Share Leases for the Period 1926-53 (1926 = 100).

Year	Type of rent: Cash	Crop-share	Livestock-share
1926	100	100	100
1927	177	96	119
1928	135	122	136
1929	112	120	144
1930	307	168	180
1931	—[a]	719	—[b]
1932	—[a]	—[a]	—[b]
1933	127	94	126
1934	105	69	133
1935	103	103	160
1936	80	133	146
1937	182	126	176
1938	164	131	129
1939	110	119	131
1940	117	115	132
1941	85	117	158
1942	56	109	151
1943	54	136	142
1944	93	147	137
1945	99	148	136
1946	66	109	157
1947	54	89	155
1948	102	158	181
1949	73	166	163
1950	68	131	160
1951	69	129	157
1952	73	161	124

[a]Net farm income was negative.
[b]Net farm income negative, landlords' net income negative.

TABLE 2. Trends in Kind of Rent in Iowa From 1900 Through 1950 by Decennial Periods as Reported in U. S. Censuses of Agriculture.

Year	Kind of rent			
	Cash only	Shares only	Share and cash	Other
	Pct.	Pct.	Pct.	Pct.
1900	56	—[a]	—[a]	—[a]
1910	53	26	17	4
1920	50	29	18	3
1930	45	26[b]	25[b]	4[b]
1940	29	22	44	5
1950	17	31	46	6

[a]The remaining 44 percent of the rented farms were not further classified by kind of rent for 1900.
[b]Estimated.

found the 165 "solutions" could be classified into three groups as an aid in understanding their nature.

In 45 cases, difficulties in making rental adjustments led to termination of rental arrangements. This resulted in the cost and inconvenience of tenants finding new farms or occupations and landlords finding new tenants. The interviews revealed that most of these moves could have been prevented by leasing provisions having greater flexibility.

In 26 cases, landlords and tenants changed kind of rent as reflected in table 2. Also, 10 of the 45 cases above changed kind of rent when changing rental partners.

In the remaining 94 cases, changes in leasing provisions were worked out within the same kind of rent by the same landlord and tenant.

Kind of Provisions . . .

We found three kinds of specific provisions designed to adjust rents to income changes in use by the landlords and tenants in this study.

One provision, called the "base and bonus" plan, involves agreement upon a "base" rent—which is the same for each year—and the negotiation of a "bonus" for either the landlord or tenant at the end of each year, the bonus being based on the cost and price relationships that prevailed during the year. This has often proven satisfactory during the past 15 years. Much depends on the ability of both parties to arrive at a satisfactory rent at the end of the rental term. This plan doesn't provide for effects of reductions in crop and livestock production and hence isn't geared to all major kinds of future changes.

Another plan, a "cash or share option" idea, provides for two alternative rent possibilities — one cash and the other share. The tenant selects the arrangement he believes most beneficial to him by notifying his landlord of his intentions before September 1. The basic weakness in this plan is that the tenant has the sole choice.

The third plan, with a "commodity price adjustment" idea was used on nine hog-producing farms. This plan included (1) determination of a base rent—$6.75 per acre, for example, on one of the farms, and (2) a provision for adjusting the rent up or down at the rate of 25 cents for each $1 change in the local price of hogs per hundredweight on a particular day. This plan was considered satisfactory by both landlords and tenants during its period of operation, 1940-52. But crop yields were relatively high in this period with no major death losses in hogs. This plan doesn't compensate for production failures of crops or livestock.

Though not found in the interviews, another proposal for rent adjustment has been made by several state experiment stations and is known to be in use on some Iowa farms. This plan provides for rent adjustments in line with the "prices received" index which includes major farm commodities of the state. This arrangement starts with an agreed base rent per farm or per acre. The rent is raised or lowered each year in direct proportion to the annual changes in the index of prices received for all of the major farm products. But there are three basic weaknesses in this adjustment plan: (1) It doesn't provide for all variations in production, (2) the price changes of all major farm commodities may not coincide with the prices of particular products grown on a particular farm, and (3) changes in cost are ignored.

Still another plan proposed by several experiment stations provides for rent adjustments based on both price and production changes. It, too, provides for a base rent with adjustments in line with the "prices received" index. But in addition, this plan provides for rent adjustment in terms of yield changes resulting from floods, drouth, insects, diseases and similar factors beyond control. Production changes for the locality, rather than on the specific farm, are used to determine the rent adjustment needed. Though this plan is an improvement over the others, it doesn't take changing costs into account —a weakness of all of the plans.

Some Guides . . .

Based on the results of this study so far, there appear to be four general guides worth considering by landlords and tenants in developing rent adjustment procedures to overcome the problems outlined in this article:

- Adjustment procedures should be worked out ahead of the leasing period, be clearly stated in writing, agreed to by both parties and signed.

- Adjustment procedures should encourage efficient use of resources so that the income to be shared is greatest.

- The procedures should provide for changes in *prices* of farm products to be produced on the farm, for changes in farm *costs* and for changes in farm *production* beyond control of the operator.

- The rent adjustment procedure should be legally valid, readily workable and not unnecessarily complicated.