LANDLORD TENANT RELATIONS

A Report of the
Landlord Tenant Relations
Subcommittee of the
North-Central Regional Land Tenure Committee

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A. The framework within which landlord and tenant relations are built is continually changing. There is need of a current appraisal of these changes. Some of the developments which contribute to the need for such an appraisal are:

(1) The adoption of mechanical power such as combines, corn pickers, hay balers, ensilage cutters, etc.

(2) The increasing importance of soil maintenance, such as liming, commercial fertilizer, the increasing appreciation of the importance of maintaining humus, conservation practices, contour cultivation and strip cropping, sod waterways, etc.

(3) Changing price relationships. Labor costs are now relatively high in relation to other costs. Interest costs are relatively low.

(4) Increasing importance of building and other capital items due to more livestock and more equipment and the need for labor saving devices.

(5) The demand for a better level of living on farms, as reflected through better housing, electricity, running water, sewage, etc.

(6) New property rights growing out of group action, such as milk and tobacco bases, conservation payments.

(7) Changes in type of farming and farming practices.

(8) Introduction of new enterprises and shifts in the relative importance of the several enterprises.

(9) Changes in the relative bargaining power of landowners and tenants as a result of supply and demand and financial position.

B. At any given time there are many factors which contribute to harmonious relations between the landlord and the tenant. Some of these factors are items within the lease agreement and some are external to the lease.

Objectives in the lease to enable and encourage profitable farming:

(1) An equitable division of the expenses and receipts. (For the purpose of this discussion an equitable division of expenses and receipts was interpreted to mean a division in which the expense items are shared in the same proportion as the receipts).

(2) Provisions for maintaining and improving the farm resources.

(3) Provisions for living.

(4) Provisions for a reasonable degree of security.

Conditions affecting the lease:

(1) Personal relationship.

(2) Custom and legal framework.

(3) Community attitudes and facilities.

(4) Participation in community affairs.

(5) Alternative opportunities.

(6) Size and quality of farm.

C. An Equitable Division - The question of what is an equitable division of capital contribution, and items of receipts and expenses by landowner and tenant under the above definition was given consideration by the committee. The conclusion was reached that an answer cannot be given to this question item by item. What will be equitable depends upon the terms of the agreement as a whole. In the past, it has been generally accepted in leasing farms that the owner furnishes the farm and fixed improvements, while the tenant furnishes the labor and the major part of the equipment. There is a need of appraising the contribution of the two parties to determine whether the sharing of both the expenses and income provide an equitable arrangement between the parties.

One of the important objectives of a farm lease is to provide for an equitable division of the farm income and expenses between the landlord and tenant. The rent, paid either in cash or a share of the produce, varies from one area to another and is largely the outgrowth of custom which has been influenced by the productivity of the land and the tenant's costs of operating the farm. Differences in the original productivity of the land between regions have been recognized as indicated by the differences in the share of produce or the amount given as rent in different parts of the midwestern states. For example, there are large areas where land is rented for one-fourth or one-third or one-half of the crop. As the agriculture of an area becomes older, the changes in methods of production, the development of serious problems of soil conservation, changes in types of farming, and changes in technological developments give rise to questions of adjusting the provisions of the lease to provide for the more equitable division of expenses and income.

Even though the soil of a community may have been similar when the land was developed for farm use, differences in the income from farms within the same community result from the degree of care and upbuilding that has been given over the years to the land and improvements on the land. Under such conditions custom is not a safe guide in developing a lease for a given farm. It may, for example, cost a tenant as much to operate a farm that will not produce more than half as large yields as another farm in the same community. These differences in the productive value of farms in the same community become more marked as an agricultural region becomes older. A suggested procedure for computing the total contribution of landlord and tenant and the percentage which each contributes to the total is presented. The basic philosophy of this procedure is that the receipts should be shared in the same proportion as the expenses.

Testing Farm Leases - One method of determining whether a particular farm lease is equitable or not is to estimate the total contributions which both the landlord and the tenant expect to make toward the annual cost of operating the farm in question. If records of receipts and expenses are available for the farm for several years these estimates may be made with considerable accuracy. Caution must be used in placing valuations for various items on a comparable basis. For example, if conservative valuations are used for labor during the war years, equally conservative values should be placed on land and other capital items. If such records are not available for a given farm, data from records of similar farms may serve as a basis for estimating the contribution of the two parties. Such estimates will lack much of being accurate, but they do serve to indicate whether or not a proposed lease is equitable.

Any estimate of this kind is subject to the judgment of those who make the estimates with respect to a considerable number of items. Under all forms of leases the landlord furnishes the farm and usually makes all the fixed improvements. His major contribution is represented by a fair interest return on a conservative valuation of the property; hence, judgment must be exercised in estimating both the value of the property and the rate of interest to be expected on that valuation. Likewise, the operator of the farm furnishes his own labor and management and the labor of members of his family on which a valuation should be placed. Such items may be difficult to estimate although there are many items of farm operating expenses that can be quite accurately estimated for a given farm. Such estimates also serve to set forth the importance of unusual provisions which may be written into farm leases.

There are two ways of securing equitability in a farm share lease. The first assumes a fixed division of income between landlord and tenant and then proceeds to adjust the division of expenses in order that they may be in the same proportion as the division of income. The second involves a listing of a fair evaluation of the contribution of each party and then suggests that income be divided on the basis of the relative contribution of each. Each method bears the assumption that the landlord and tenant should share the income of the farm in the same proportion as they contribute to the expenses involved.

A process of evaluating the contributions of the landlord and tenant for a given farm is illustrated by the balance sheet on the following page which was made up in accordance with the terms of a typical crop and livestock share lease.

In the illustration the value of the farm land is given as $42,000 and the annual contribution of the landlord is estimated at four percent of the value. The basis used in determining the rate of interest is the prevailing rate of interest paid on good farm mortgages. The house which is evaluated with the other buildings is a much better house than would be found on the average farm and represents a definite investment from the standpoint of the landlord. Tenants who are successful farmers will frequently be willing to pay something additional for an excellent home. The contribution of the house and other buildings is valued at four percent the same as the land. The operating capital including livestock, machinery, and feed valued at conservative inventory values is estimated at five percent because the interest on money borrowed on operating capital usually costs about one percent more than the rate paid on good farm mortgages.

Contributions of Tenant and Landlord for One Year Under a Livestock Share Lease for a 220-Acre Farm

	Value	Percent interest	Expenses Total	Tenant	Landlord
Investment items					
1. Land	$42,000	4	$1,680		$1,680
2. Buildings	12,690	4	508		508
3. Work animals	300	5	15	15	
4. Other livestock	1,890	5	96	48	48
5. Machinery and equipment	3,734	5	187	187	
6. Feed for livestock	960	5	48	24	24
Total interest charges			$2,534	$274	$2,260
Other expenses					
7. Management - landlord			$ 200	$	$ 200
8. Operator's labor and management			1,400	1,400	
9. Unpaid family labor			600	600	
10. Hired labor			300	300	
11. Cash cost of board for hired labor			100	100	
12. Purchased feed for productive livestock			152	76	76
13. Depreciation on work animals			20	20	
14. Machinery and equipment depreciation and repairs			610	510	100
15. Building depreciation and repairs			300		300
16. Skilled labor (not furnished by tenant)			100		100
17. Fence repairs and depreciation			80		80
18. Machine work hired			100	50	50
19. Livestock expense			152	90	62
20. Seeds and twine			158	79	79
21. Limestone and rock phosphate			200		200
22. Commercial fertilizer			200	100	100
23. Tractor fuel			300	300	
24. Insurance on buildings			60		60
25. Insurance on livestock			50	30	20
26. Taxes on real estate			365		365
27. Taxes on personal property			60	40	20
Total expenses			$7,941	$4,069	$3,872

In this illustration it is assumed that the owner of the farm employs a hired manager to look after the farm at a cost of $200 a year which is a cost of management from the standpoint of the farm owner. The figure to be placed upon the operator's labor and management and that of the unpaid family labor will be difficult to estimate. The latter might be based on the estimated cost of the labor which would be hired if no family labor were available. The operator's own labor in this example has been entered at $100 a month plus $200 as his contribution to management giving a total of $1,400.

In this illustration it is recognized that in addition to the wages estimated for the operator and members of his family, that the family receives certain produce which is contributed by the farm to their living and use of the house. The question might be raised as to whether or not the value of such produce and house rent should be estimated and added to the farm income. If this was done, the value of the labor of the operator and members of the family would presumably be increased by a like amount. It makes little difference which of the two methods is followed.

The cost of hired labor and board may be quite closely estimated. The other items of expense may be secured from records of the farm in question or estimated from records on similar farms.

In the illustration given above, it is shown that the tenant's contribution is $297 more than the landlord's. While the valuation of some of the items in the illustration might be changed to balance the contributions of the two parties, it may be assumed for the sake of our illustration that the figures are fairly chosen. The tenant might be willing to pay more than 50 percent of some of the items of expense because of the better house he has for his family to live in. On the other hand, the landlord might reason that he gets a better tenant because of the better house and will get paid for this additional investment by the larger earnings from the farm. Taking the latter point of view, it might be advisable to try to balance the contributions of the two parties. If, for example, the landowner had made a payment toward the cost of the tractor fuel of approximately one-half the cost thus taking away $150 from the contribution of the tenant and adding it to the landlord's total, it would have practically balanced the contributions of the two parties.

In the foregoing example, on the basis of the estimates made of the contributions of the two parties, only a minor adjustment in the contributions is required to make a 50-50 division of the income, an equitable arrangement for this farm. If, on the other hand, the farm used in the illustration had been less desirable from the standpoint of both land and buildings, and landowner's contribution might have been estimated at $1,000 less in terms of interest on the valuation of the "land" and "buildings". This would have given the total contribution of the tenant as $4,019 and the landowner $2,722, or expressed in percentages, as approximately 60 percent and 40 percent. This indicates that a 3/5 to the tenant and 2/5 to the landlord division of the income would have been more equitable since a change in the shares of the income would call for only minor changes in the sharing of contributions.

These illustrations show that this method of analysis may be used for either of two purposes: 1) To adjust the contributions of the two parties to make a specified sharing of income correspond to the sharing of the contribution or 2) to adjust the sharing of the income to fit the contributions. It should be made clear that this method of attempting to balance the contributions of the two parties or changing the sharing of the income is really no better than the judgment of the people asked to evaluate all the contributions of the landowner and the tenant. It is, however, an excellent means of testing out leases to see whether they give an approximate equitable adjustment of expenses between the two parties in accordance with the share they receive of the total farm income.

Some Problems in Dividing Expenses - The cost of purchased lime and fertilizer is an item which may be subject to considerable discussion from the standpoint of how much of the cost should be borne by the landowner and how much by the tenant. It might be stated that if a farm is badly depleted when the tenant moves to it and the farm is renting on a basis comparable to more productive farms that the landlord might well assume the responsibility for the purchase of "long-time" fertilizer such as limestone or rock phosphate to bring the farm up to a higher level of production. On the other hand, if a farm is highly productive when a tenant moves to it, it may be reasoned that the tenant should contribute his share toward maintaining its productivity as he is participating in the advantages of a highly productive farm compared with many others in the same community. In recent years on most farms the conservation payment has been applied to the cost of limestone, rock phosphate, or other fertilizers. Normally the cost of quick fertilizers from which the major value is realized in the same year they are applied is shared by the landlord and tenant in proportion to the sharing of crops. The cost of spreading limestone has been handled in various ways, sometimes being shared by the landlord and tenant, while in other instances either of the two parties may bear the expense.

The cost of tractor fuel may be questioned as a charge against a tenant under a livestock lease. In a livestock lease if the farm work was done by horses they would probably be fed from undivided grain. The landlord would be contributing half of the cost of feed although the tenant would furnish the horses. When the work is done almost entirely with the tractor, it may be reasoned that it is fair for the landlord to make some contribution to offset the saving in the cost of feed for work horses. Many landowners do not like to be involved in securing a fair statement of the cost of fuel. Some make a contribution of 50 to 100 cents an acre for cropland to help pay for the cost of tractor and truck fuel. The amount of the contribution should depend somewhat upon the amount of fuel used on the farm. On a heavy livestock producing farm, where power is used for grinding feed and many other purposes, there may be a justification in the landlord paying a larger sum toward the cost of fuel. In some instances landlords make concessions in other expenses to offset part of the tenant's power costs.

In the operation of a dairy farm a very large amount of labor is required compared with most types of farming. Because of the labor involved, some dairy farms are rented on a basis of 60 percent and 40 percent respectively to the tenant and the landlord, or in other instances the landlord may furnish more than half of the dairy herd, or pay part of the labor expenses, or make some other major contribution to equalize the contributions of the two parties.

D. <u>Providing for Maintaining and Improving the Farm Resources on Rented Farms</u> - The maintenance and improvement of our farms is of concern to all of us. It is to our interest to have the farm pass from one generation to the next in an improved state of cultivation.

In the past it has too often been the practice to operate the farm without regard to the maintenance of the soil and its improvement. When the farm was worn out, the operator moved on to virgin land. The day of land surplus is past and as we look forward it becomes paramount that we not only conserve what we now possess but also improve its productivity for future generations.

Recognizing that farm resources must be maintained or improved in order to provide for a profitable system of farming, the farm lease must provide for the care of the property. If this is not done, the reduced productivity of the farm will lead to unsatisfactory income for both the tenant and the owner and depreciation in the value of the property.

Most of the farms in the United States are owned by individuals and change ownership upon death. This gives uncertainty as to the length of occupancy of a tenant. Many rented farms are owned by estates or individuals that are more interested in the current income from the farm than they are in building up or even maintaining its long-time productive capacity.

Tenants in the United States are a distinctly mobile class as compared with those in countries such as England with its older and more stable agriculture. As tenants acquire experience and capital it often becomes economically desirable for them to move to larger and better farms. Eventually many of them will leave the tenant class and become owner operators. This tends greatly to shorten the period of tenancy on any one farm.

Tenants should be free to move to better farms or to acquire farms of their own as their abilities and capital accumulations develop. In many cases the landlord may hold these tenants for a longer period by making his farm a better farm and therefore more attractive to them. This can be accomplished by improving the productivity of the land and providing better improvements, especially a better home equipped with modern conveniences. This may lessen the mobility of tenants but does not eliminate it. Any plan for improving landlord tenant relations must recognize the relatively short period of tenancy on any one farm in the United States as compared with other countries.

The farm owner has an interest in maintaining or improving the farm as well as in current cash income. The tenant is interested in having a farm with the productive capacity and facilities with which to make a profit and a satisfactory living. It is to the long-run interest of both parties that these improvements be made. Since both will share in the receipts resulting from such improvements, the question arises as to how should the costs be shared.

The tenant who moves to a farm that has been seriously depleted by past negligence cannot be expected to contribute to the improvement of the farm to the same degree as the tenant who has been directly responsible for the deterioration unless the terms of the lease are adjusted. Due to the reduced productivity of many farms it is difficult for a tenant to meet all of his expenses and make an acceptable living from a badly depleted farm, especially if he attempts to pay the customary rental for that community. With the wide variation in the production of farms in the same community, new standards for renting farms need to be developed, which are based upon the productivity of the farms and which assume that the farm will be properly operated and maintained. The tenant who moves to a farm where the land and improvements have been well maintained might well be expected to contribute more to the maintenance of the farm than the tenant who moves to a badly depleted farm assuming that the terms of the rental agreement are otherwise the same.

Two problems are apparent on rented farms as related to productivity. One is that of maintaining the present productive capacity, the other that of improvement over the present level. The responsibilities and interests of the owner and the tenant may differ in relation to these two problems.

With the development of markets and methods of production, there is frequent need of adding buildings, fences and other improvements which are needed for a new or improved system of farming. For the improvement of the badly depleted farm and for the maintenance of all farms, leases need to be developed on a basis that will provide for permanent farming.

Basically in maintaining or improving farms there is a difference between cash renting and share renting. In the United States over three-fourths of the rented farms are rented for a share of the crops or a share of the crops and livestock. In cash renting the tenant gets all the current benefit from improvements put on the farm except as cash rentals are increased because of the improvements, or a better tenant is secured. The landowner benefits, however, if the improvements add to the value of the farm. In share renting the current advantage from the improvements put on the land are in many cases shared by the two parties in proportion to the sharing of the income. This means that improvements contributed to the farm by the tenant are often shared very directly by the landowner as far as current income is concerned; the landlord gains the major advantage from any increase in the value of the property. Other improvements such as those which result largely in reducing the labor cost of operation are of advantage largely to the operator. This raises questions of who should make the improvements of different types.

Financing Maintenance and Improvement Costs - There are three alternatives in the financing of outlay for maintenance and improvements on rented farms: (1) by the landlord, (2) by the tenant, and (3) jointly by both parties. It would seem equitable that the cost of items that serve only to maintain the productivity of the farm be shared between the owner and operator in the same proportion as they share the benefits of these items. The landlord has a double interest in the maintenance and improvement of the property: On the one hand it raises the value of his property and on the other hand it should increase his current income from the farm. An advantage of the landowner making the improvement is that questions of joint ownership are avoided. A problem arising when the landowner pays for all the improvement costs is whether he will be adequately compensated out of the increased income or whether it will be necessary for him to demand an increase in the cash rent or a modification in the terms of the share arrangement. Sometimes this adjustment may lead to a shift in tenants. Frequently these improvements result in lower costs of operation which are an advantage largely to the tenant. A disadvantage to the owner paying the full cost of all improvements is that it is liable to lead to demands by the tenant for still further improvement sometimes without due regard to their cost. Or the tenant may not have the interest and incentive to take care of what is added.

Many landlords are not fully aware of the necessity of making improvements since they are not as directly involved in carrying on the operations of the farm as is the tenant. Again many landlords dependent upon the income from the land do not possess the necessary capital to make improvement. Where the landlord makes all the improvements, it may involve hiring the necessary labor which makes many forms of improvement expensive. It may even be questionable whether the farm will rent for enough more to pay for the improvements if they have been made at a high cost.

Many problems also arise when the making of improvements is considered an obligation of the tenant. In the first place, the tenant frequently lacks the capital with which to make improvements. In the second place, where the improvements are made by the tenant on a share rented farm the benefits of these improvements must be shared with the landowner unless an adjustment is made in the lease. Another question which arises in the mind of the operator is whether he will remain on the farm for a long enough period to fully realize the benefits. This latter objection could in part be overcome by the development of a plan for compensating the tenant for the unexhausted value of improvements should he leave before they have been fully realized upon.

The third alternative is the common one employed--that of the landlord and tenant sharing in the cost of maintenance and new improvements. This is becoming of increased importance because a stage has been reached in the agriculture of the midwest where new capital must be put into farm property to maintain or to increase its productivity.

Many improvements are for the mutual advantage of the landowner and of the tenant, especially those improvements that add to the current farm income. Other improvements may be primarily to the advantage of the tenant, such as the rearrangement of a barn to lessen the tenant's cost of handling livestock, the erection of a machinery shed to house the tenant's machinery, or the installation of electric lights which provide better living conditions or save labor.

It may, however, be to the advantage of both parties to share in improvement costs if this is the most economical method of providing the improvement and the cost can be shared equitably when safeguarded by a well drawn lease.

In share or share-cash renting there is a greater incentive for the two parties to share in the cost of improving the property because they share in the increased income derived from improvements put on the farm. The essential point is that the provisions of the lease should provide for the sharing of the costs of improvements in proportion to the benefits derived. To be equitable the investment of added capital in the form of labor or materials for new improvements must take into consideration both the increase in the current income and the increased value of the farm property.

E. Provisions for Better Living - A characteristic of American agriculture is that the standard of living has improved as agriculture has grown older. In general, the progress in areas of heavy tenancy has not been as rapid as on farms of owners in the same area. Part of this lag can be attributed to the fact that the landowners have frequently moved from the farms now occupied by tenants and have not kept informed concerning the modern improvements which farm owners are installing on their own farms. Also, many think in terms of the kinds of conveniences that were on farms when they were there. Many owners find need for all the income from the farm to meet their own living expenses, especially if illness or other misfortunes are experienced.

The best improved farms, especially with good home facilities, usually attract the best tenants. Second-rate farms get second-rate tenants, which in turn results in reduced farm earnings for the owner. The landowner must be aware of the fact that levels of living are advancing. This includes such things as provisions for a good water supply, sanitation, electricity, and modern improvements. This is true on the farm as well as in town. Provisions on the farm for a good standard of living, therefore, are not only desirable but they are essential to profitable farming, good living, and good community development.

Tenants, themselves, need to accept part of the responsibility for improved living facilities. Landowners are more willing to help tenants have better living conditions if tenants show their appreciation for improvements by taking good care of the home and by making minor improvements, especially when the landowner is willing to meet the actual cash cost of such improvements. Many tenants seem to fail to appreciate that money spent by the landowner on the house and modern improvements are often for the direct benefit of the tenant.

F. Security - One of the most frequent excuses given by tenants for not mak- improvements on a farm is the feeling of insecure tenure. The need is to improve the feeling of security on the part of tenants.

The conditions pertaining to security include not only length of tenure, but also adequate lease provisions for reimbursement for unexhausted improvements when the tenant is required to quit the farm, and notification of termination of the lease at least six months in advance of the end of the lease. There is a growing tendancy to give the tenant a continuous lease unless he is notified of its termination at least six months in advance.

G. Suggested Lines of Research

(1) The equity of various types of leases.

Compute the expenses and receipts of the land lord and tenant under various methods of renting and under varying conditions.

(2) Flexible rental agreements pertaining to cash rentals.

The methods by which the current cash rental can be adjusted to the changes in the price of farm products.

(3) The period of productivity of the various types of investment.

This type of data will be necessary in calaulating the unexhausted value of various investments of capital and labor on the farm.

(4) How best to finance conservation improvements on rented farms.

The division of expenses between landowner and tenant for the various types of land conservation expense which would be equitable.

(5) Compensation to the tenant for improvements made and to the landowner for damage done by the tenant.

A study of the various means and methods of compensating the tenant for improvements made. The relative merits of making these improvements by the landowner or the tenant.

(6) The financial position of owner and tenant as a factor in making or limiting improvements.

To what extent are the lack of improvements on rented farms due to the lack of available capital on the part of the landowner. Is the landowner or the tenant in a better financial position to make these improvements.

(7) Financing home improvements on rented farms.

To what extent may the tenant be expected to participate in maintaining and improving the farm home.

(8) The effect of changing technology and new enterprises on the terms of farm leases.

When a corn picker, hay baler, milking machine, silo or other new methods are adopted on the farm, adjustments may be required in the farm leases to maintain an equitable division of receipts and expens

(9) The adaptation made by landlords and tenants in available lease forms. Most of the Midwest Land Grant Colleges have prepared and have available farm lease forms. It is suggested that studies might well be made of the changes which have been made in these leases by those who use them.

(10) Leases which allow for the progressive development of the operator. How best to provide in the lease for the promising young tenant operator to acquire an increasing equity in the farm operating capital as he accumulates capital and experience.

(11) Why tenants move and why landlords change tenants.

There is a need for studies as to the tenants and landlords opinions as to tenancy, its advantages and disadvantages.

(12) The legal aspects of leasing agreements.

There is need for a careful consideration of the legal aspects of leasing agreements.

(13) The rental market and rental determination.

The extent to which custom, competition and variations in productivity determine rents.

(14) The effect of new property rights growing out of group action. Soil conservation payment and tobacco allotments are examples of new property rights. How should these be shared by the tenant and the landowner.

(15) The deliniation of type of tenancy areas.