

Agricultural Leasing – a Tool for Prosperity

The cost of agricultural land in California continues to escalate. Nowhere is this more evident than in Marin, Napa and Sonoma Counties. Wealthy buyers from around the world continue to snap up large tracts of North Bay real estate at prices that farmers and wine producers cannot match.

Meanwhile, a new generation of farmers sees opportunity in our region. The wine industry is thriving, along with specialty crops that support restaurants and the demand for local food sourcing. The return of hop farming to Northern California is an inevitable trend as craft brewing explodes in the Golden State.

Leases Serve the Interests of Owners and Farmers

Many entrepreneurs cannot afford to own all the farmland needed for efficient scale of operations. The agricultural lease is a tool that enables farmers and wineries to conserve capital for essential labor, machinery and management. A successful strategy is to operate a combination of owned and leased land. This allows the business owner to have a home base for equipment, processing and storage while leasing additional acres for production.

The agricultural lease is also an important arrangement for property owners. Many owners need someone to farm their land to provide a return on their investment as well as maintain productivity. Landowners view leases as a means to retain their investment in the land and to provide security, retirement income and income tax deferral. Leasing also provides a hedge against inflation through appreciation in land values over time.

Leasing land for agricultural purposes is promoted by state and local government

through zoning and other regulations. At the state level, leases are encouraged by an important exception to the Subdivision Map Act that allows an owner to carve out a portion of a homestead property and lease it for Ag purposes.

Leasing farmland successfully requires an agreement that benefits both the owner and the operator. A well-drafted lease facilitates the combination of landlord and the tenant resources for efficient production of commodities. The lease agreement also protects the legal rights of all parties involved.

Common Types of Leases

Two common types of leases used for agriculture are the fixed rent lease and the flexible rent lease.

Under a fixed rent lease the tenant pays specified rent per acre for use of the farm resources. The landlord may restrict what crops can be grown and designate which conservation and agricultural practices are employed. Otherwise, the tenant manages production and receives all the crop revenue.

Under a flexible lease, the rent depends on actual yields attained and commodity prices. In the wine industry, rent payments will be tied to prevailing prices paid for various grape varieties. The landlord shares some of the risk of low yields or declining prices, but also benefits when prices or production rise.

As farming practices become more sophisticated, lease instruments also become more complex. Vineyard leases are frequently drafted "triple-net" leases, whereby the tenant pays rent, taxes, insurance, maintenance and operating

expenses. The landlord enjoys a steady income stream while the tenant operates and maintains the property.

Before Signing the Lease – Tenant's Due Diligence

Due diligence on agricultural property includes review of title, water rights, irrigation infrastructure and improvements, environmental review, land use and zoning restrictions, and third party contracts.

A title search will enable the prospective tenant to understand whether its possession of the premises could be at risk due to foreclosure of a mortgage. The Tenant will want to know whether the consent of a lender is needed to lease the premises.

A prospective tenant should ensure that the actual owner is a party to the lease. A title report will identify the actual owner of the property.

Third party easement rights can negatively affect growing or harvesting activities.

Water sharing agreements are common in agricultural areas. The rights of third parties to water must be clearly understood.

Important Lease Terms

A written lease brings certainty by laying out important terms such as rent formula, conservation practices, lease duration, and notice termination events. In California, an agreement to a lease for more than a year must be in writing to be enforceable.

In any agricultural lease, the following issues should be covered:

1. Define the premises to be leased and the tenant's access to the premises. The precise terms of

access easements must be understood to ensure that vehicles and harvesting equipment can be brought on to the property.

2. Clearly define the sharing of expenses and production.
3. Agree on the responsibility for maintaining buildings, facilities, and soil.
4. Decide when and how the lease can be renewed and how the rent can be renegotiated or recalculated.
5. Decide who can make any alterations or improvements to the premises.
6. Allocate risks with appropriate indemnity and insurance clauses.
7. Landowners should try to limit the tenant's ability to terminate for lack of water or infestation.

After Signing the Lease

Both parties should maintain good records of payments and farm management practices. Recordkeeping reduces the risk of a dispute after the lease is signed.

Conclusion

The trend over the next several decades will be for more of California's farmland to be leased rather than operated by its owners. A well-drafted agricultural lease prevents many legal problems by requiring the parties to consider explicitly the terms they are agreeing to. Both the owner and the tenant will want to engage an experienced real estate attorney to guide them to a written agreement that protects both parties.



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