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Leasing Farm Buildings and Livestock Facilities

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Farm buildings and special use livestock facilities many times will outlast their intended use for which they were originally constructed in a farming operation. These buildings represent a valuable capital investment whose remaining value may not ever be utilized by the owner. Other farm operators may desire new or additional buildings or facilities but lack the capital needed to invest in new construction. Both parties could benefit from the development of a leasing arrangement where a lessee can utilize these existing farm buildings and livestock facilities in his or her farming operation. The owner receives a return on his or her remaining capital investment that might otherwise lie idle and never be recovered. These buildings and facilities could be utilized by the lessee without making a large capital investment.

However, before such a mutually beneficial arrangement occurs, the owner and the lessee must agree on rental payments and the use and care of the property. Any lease arrangement should be built on honesty and trust, and should benefit both parties. This fact sheet is intended to explore and consider the factors involved in developing rental agreements for leases for farm buildings and specialized livestock facilities from the view of both the owner's and renter's perspective.

Establishing Owner's Costs

"What should I charge for the use of my farm building(s)" is the question that the building owner must answer before discussing a leasing arrangement for his or her buildings. While the owner can usually establish the undepreciated value remaining in a building, this remaining value must be weighed against the fact that he or she is not in a position of fully utilizing them for their intended purposes. Ownership or fixed costs of owning a building or livestock facility are depreciation, interest, repairs, taxes, and insurance. These "DIRTI" costs categorize the owner's costs.

Depreciation—The annual depreciation for buildings and livestock facilities is based upon the remaining capital investment in and the remaining useful life not credited against previous use in a farming operation. A building that has an estimated ten-year life remaining depreciates at an average of ten percent of the remaining value annually. Remember that depreciation is used here to establish a decline in value due to use and obsolescence resulting from activities of the lessee. IRS rules permit the write off of depreciation at a rate different than ten percent. Buildings and facilities that have been fully depreciated may be considered to have no depreciable value remaining.

Interest—The interest rate on intermediate loans and/or the rate of return from other fixed investments can be used to estimate the interest costs on capital investments. The current value of existing building and livestock facilities multiplied by the rate selected can establish a value for current annual interest costs.

Repairs—The cost of repairs and normal upkeep of a building or livestock facility is a cost of ownership borne by the owner. These costs, unlike other ownership costs, tend to increase as the age of the building or facilities increases. Table 1 from NCR-214 "Rental Agreements for Farm Buildings and Livestock Facilities" below suggests some rules of thumb for establishing these repair costs.

Table 1. Guidelines for Estimating Annual Repair Costs

Item	Useful Life Years	Repairs % New
Livestock Building	15-25	1-3%
Livestock Equipment	5-10	3-5%
Grain, Storage/Dryers	15-20	3-4%
Machinery and Hay Storage	20-25	1-2%

Taxes—Property taxes paid on buildings and livestock facilities should be considered as a cost of ownership. However, specialized livestock equipment are considered personal property in the state of Ohio and would not be taxed. Actual tax costs should be available from tax bills.

Insurance—The cost of insurance against fire and storm damage on buildings and livestock facilities is a cost of ownership. The costs of insurance can be estimated from insurance policies or by contacting your insurance underwriter. In summary, consider Table 2:

Table 2. Guidelines on Annual Overhead Costs

DIRTI Costs	% of Mid-Value
Depreciation	7.0%
Interest	5.0%
Repairs	1.7%
Taxes	0.5%
Insurance	0.5%
Total	14.7%

Source: Edwards, Iowa State University

For example, a $100,000 building could have $14,700 in overhead costs ($100,000 x 14.7%). Analysis reports of actual farm operations have established general guidelines of what the "DIRTI" costs should run. These guidelines are expressed as a percent of the mid-value of the farm building or livestock facility, with the mid-value being one-half of the original value of the building or facility.

Establishing the Value of a Building or Livestock Facility for the Lessee

The person interested in leasing the farm buildings or livestock facilities also must establish what value he or she can afford to pay for the use of same. Questions to be answered are: how much can I afford to pay?; how much should I pay?; and how much income will I realize from leasing the facilities?

The leasing of farm buildings and facilities makes it possible for the lessee who lacks the capital to invest, to obtain the use of, and generate farm income through the use of those buildings and facilities. A proper management tool to use would be to estimate expenses and income using enterprise budgets. An example would be the Ohio Enterprise Budgets published by OSU Extension and the Department of Agricultural, Environmental, and Development Economics at The Ohio State University. In the case of livestock production, enterprise budgets estimate a cost for buildings and overhead costs based on new construction.

A partial budgeting approach may also be of value in establishing the worth of available facilities. With a partial budget, the lessee estimates the added value by comparing added income plus reduced costs against reduced income and added cost for not using the building.

Added Income + Reduced Costs	vs.	Reduced Income + Added Cost
Total Returns		Total Expenses

Leasing of farm buildings and livestock facilities should increase total returns by producing additional income and could, through size and scale factors, reduce costs of production. On the expense side, leasing costs will reduce income through additional cost. Careful consideration using a partial budgeting approach can establish how much rent can be paid for buildings and facilities.

Estimating a reasonable value for renting grain storage facilities and building use for the storage of farm equipment can be obtained by using reviewed publications available from Extension and university studies of farm custom rates and contract prices paid. For example, the biannual publication *Farm Custom Rates Paid in Ohio ESO 2551*, reported the average per month cost of renting grain storage as $0.03 per month with a range of from $0.02 to $0.05. *Building Rental and Contracting Rates, File C2-17*, published by the Iowa State University cites machinery storage costs in the state of Iowa as averaging $0.21 per square foot with a range of from $0.04 to $0.66 per square foot.

Lease Agreements

Massey and Edwards write this about leasing agreements which would apply to both business and private leases:

"Two general types of lease plans are available, and are distinguishable mostly by how they are treated for income tax purposes. A true (or operating) lease calls for a series of regular payments, usually annual or semi-annual, for a period of years. At the end of the lease period, the operator can choose to purchase the machine at a price close to fair market value or to extend the lease. If the farmer no longer wants the machine, it can be returned to the dealer or the leasing company that owns it. The lease payments are reported as ordinary expenses on the tax return, and are fully deductible. If the purchase option is exercised, the machine is then placed on the farm's depreciation schedule, with a beginning tax basis equal to the purchase price.

A finance (or capital) lease has a similar payment schedule to a true lease, but is treated as a conditional sales contract by the Internal Revenue Service (IRS). The farmer is considered to be the owner of the machine, and places it on the farm depreciation schedule. Payments made to the lease company (or individual) must be divided into interest and principal, with only the interest portion being tax deductible. Many finance leases are very similar to balloon payment loans set up for three to five years. The difference is that at the end of the lease period, the operator can still choose to either return the machine to the dealer and give up ownership, or make the final balloon purchase payment. Since the finance lease is not being taxed as a true lease, the final buy-out price can be quite variable, depending on the length of the lease and the size of the payments."

Some owners choose to lease buildings or equipment when transferring ownership to defer taxes on the sale.

Flexible Rent for Buildings

Some arrangements for leasing livestock buildings include a flexible rent related to livestock or product price. This allows both lessor and lessee to share in price risk and potential profits. Most establish a base rent with adjustments tied to local cash livestock prices.

This arrangement requires a careful preparation of a written lease that offers fair and equitable returns to both.

Legal Aspects of Leasing Farm Buildings or Specialized Livestock Buildings

Once a rent figure is agreed upon, a written agreement should be signed by both parties. The lease contract can be prepared by one party's attorney and reviewed by the other party's attorney.

The typical content of a farm building or livestock facility lease may contain the following provisions:

- Complete information on the owner (lessor) and the lessee.
- Property description.
- General terms including time period, amendments, transfer of ownership, right-to-sublease, transferability to heirs, and failure to pay provisions.
- Amount and payment terms of lease payment.
- Operation and maintenance of property.
- Compensation for improvements.
- Arbitration provisions.
- Signatures of lessee and lessor.

A sample lease (Farm Building or Livestock Facility Lease) NCR-215 is available from Midwest Plan Services at (800) 562-3618 or www.mwpshq.org or some OSU Extension offices at a small cost. It can be used as a guide for content and terms but should be reviewed by your own attorney.

Closing the Deal

Agreement by the owner of farm buildings or livestock facilities, and a farm operator who is willing to rent same can happen only when both parties agree on a rental cost and arrangements that are deemed acceptable by both parties. In the end, farm building rental rates come down to a bargaining process between the owners and the potential lessee. Local supply and demand conditions and other factors can and will have a bearing upon the final rental figures each is willing to agree to.

A lease arrangement, besides being fair to both parties, should foster and develop a positive business relationship for both parties. A positive business relationship strengthens when both parties understand their own position and the needs and desires of the other party, and when regular communication between the owner and lessee of farm buildings and livestock facilities occurs.

Some Results of Iowa Farm Building Rental Rate Survey

The values in Table 3 on the following page summarize rental rates reported to William Edwards at Iowa Sate University Extension by Iowa tenants, farm owners, and farm managers. The survey was carried out in 1994 and again in 1998. However, due to the low response rate in 1998 some values are omitted. No similar study has been completed yet in Ohio, but is underway in 2002.

The mid-point is the value for which half the responses were higher and half were lower (median). Individual rental rates will vary according to the age, condition, size, location, and efficiency of the building being rented. The survey assumed that tenants would pay the costs of utilities and provide labor for repairs.

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Table 3. Iowa Farm Building Rental Rate Survey

Type of Building	Unit	Year	No. of Responses	Mid-point Rent	Range
Swine					
Farrowing House	$/pig weaned	1994	40	6.00	$1.00 to 21.00
		1998	8	9.50	4.50 to 18.00
Nursery	$/pig	1998	11	4.00	1.50 to 12.00
Confinement Finishing Building	$/pig finished	1994	116	8.00	3.00 to 20.00
		1998	27	7.00	2.00 to 14.40
Open Front Finishing Unit	$/pig finished	1994	126	6.00	1.00 to 15.00
		1998	21	5.00	2.18 to 12.05
Combination farrowing, nursery, gestation, finishing houses					
	$/pig finished	1994	23	9.00	4.00 to 18.00
Contract finishing	$/pig finished	1994	13	8.00	6.00 to 11.00
		1998	13	9.00	2.00 to 13.00
Beef					
Finishing facility with open lots, feed storage, shelter					
	$/head finished	1994	12	12.60	3.33 to 40.00
Custom cattle feeding	$/head/day	1994	8	0.18	0.13 to 0.27
		1998	6	0.19	0.15 to 0.27
Dairy					
Milking parlor, loafing shed, equipment, manure handling, feed storage					
Modern, labor efficient	$/cow/year	1994	8	141.00	90.00 to 200.00
Older, less efficient		1994	4	85.00	50.00 to 125.00
Storage					
Silage, airtight silo	$/ton	1994	7	2.50	0.71 to 5.50
Silage, concrete stave silo		1994	11	2.08	0.71 to 3.26
Silage, bunker silo		1994	7	2.00	1.04 to 2.50
Hay, square bales	$/bale	1994	9	0.10	0.05 to 0.31
Hay, large bales	$/ton	1994	8	2.40	1.50 to 4.00
Grain	$/bu./mo.	1998	33	0.015	0.01 to 0.03
Grain	$/bu./mo.	1998	41	0.126	0.09 to 0.18
Machinery, enclosed	$/sq. foot	1994	87	0.21	0.04 to 0.66
	Per year	1998	17	0.25	0.06 to 0.62

Additional Internet Resources

- Iowa Farm Building Rental Survey (1998) available at http://www.exnet.iastate.edu/pubs/fm3.htm
- Farm Lease Agreements-Building, Ontario Canada Ministry of Agriculture contains information on renting and leasing of buildings. Include Canadian discussion of leasing and renting farm buildings. http://www.gov.on.ca/OMAFRA/english/busdev/facts/pub92.htm

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