MUTUAL AGREEMENT

In part I of this series, field editor Troy Smith examined a cow lease/share arrangement between two brothers and an established rancher in Nebraska. Here, in part II, we examine whether cow leasing is a viable option for others, and share some guidelines on setting up fair and legal agreements. This information comes from Gerald Warmann, Extension ag economist at Kansas State University, and Richard Clark, Extension ag economist for the University of Nebraska-Lincoln.

— JerilynJohnson

So, you're a 22-year-old, hard-working individual with aspirations to become a full-time beef producer. What's that you say? You aren't receiving assistance from your family or inheriting any farm assets? Hmmm ...

Says here you earned an FFA beef proficiency award and were responsible for registered heifer and market steer projects for eight years. You own a pickup and stock trailer, plus a little equipment. You plan to get married in June. Hmmm...

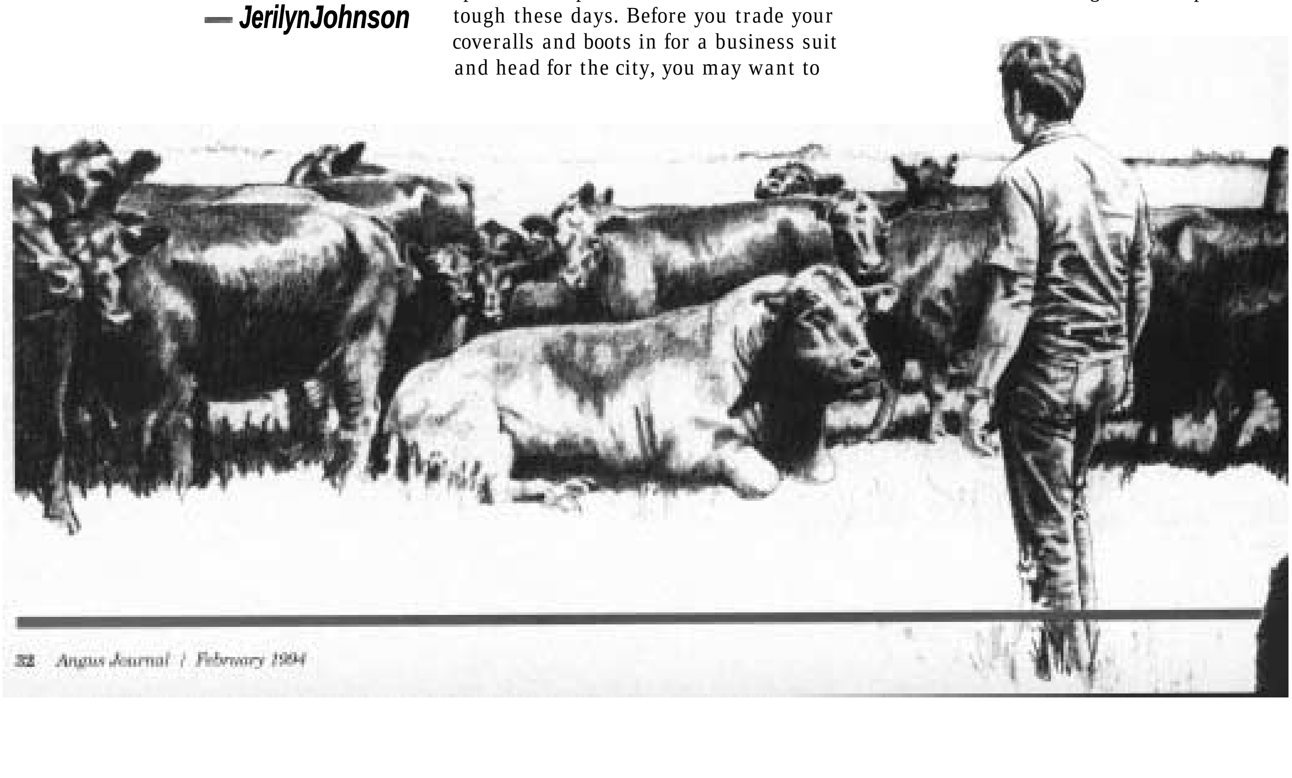
We'll review your loan application. I like your enthusiasm, but to be honest, you're a high risk candidate. It doesn't look favorable. Tough luck kid!

Many aspiring producers have nightmares about the above conversation with their banker or lender. The truth is, acquiring a loan and starting up a beef operation — purebred or commercial— is tough these days. Before you trade your coveralls and boots in for a business suit and head for the city, you may want to consider a cow lease/share arrangement. It's one alternative that has helped many producers find their niche.

What is a cow lease/share? Simply put, it is a contractual arrangement between two or more parties where one owns the cows and the second owns all or part of the other resources necessary for producing calves.

"As with many agreements in agriculture, they come in all shapes and sizes," says Richard Clark. "In most instances, the cow owner also furnishes the bulls, but not always. Sometimes the cow owner furnishes part of the feed. Usually the second party furnishes all the labor."

Cow lease/share arrangements offer a way to place capital (cows and replacement heifers) in the hands of resource-short individuals. They are also useful for transferring ownership over



time to others, especially family members. These agreements also permit the sharing of price and production risk.

"It may not be for everyone," Clark adds with caution. "Those who enter into these contracts give up some degree of control and decision-making authority."

Beef cow leasing is a business decision which should be made only after thorough business analysis. Both the beef cow herd owner (leasor) and the operator (leasee) should investigate the prospects for fair profits expected from the arrangement. Cow leasing tends to become more popular when beef market and cow prices are high. The current high trend across the country has created a resurgence of interest in this financial option, the economist says. If the market swings down, that could change.

Still, the cow lease/share arrangement is a viable option in the beef industry. In the business world of agriculture, lease agreements are common, especially for crop and pastureland. Most view cow leases as a form of investment and asset management.

In many cases, it can be an enjoyable and satisfying experience. The owner sees his cow herd continue and even be improved through wise breeding stock selection. The lease or operator benefits from the genetic foundation established by the herd owner, along with shared experience and tips from the owner. Ultimately, it can lead to ownership of your own profitable, quality beef cow enterprise.

Management Issues

Beef cow leasing represents a means to control financial and producing farm assets. To the cow owner, the herd is a financial asset — part of the portfolio of investments which are acquired and managed to generate income to the owner. To the farm or ranch operator, the herd is a producing farm asset to be managed to generate income.

A herd owner may have spent a lifetime developing a herd of cattle with specific breeding and production characteristics. Selling all of this developed capital may be both personally difficult and an unwise business decision.

A lease arrangement allows this capital to be continued and continually developed for the future. A lease arrangement may also be structured to plan for a gradual transfer of ownership from the current herd owner to the operator. For the leasor, a gradual transfer allows the owner to better manage their tax liability connected with the sale of depreciated assets. For the leasee, it allows a slower pace of capital investment. There are personal and property tax, as well as social security issues for the owner to address and understand before implementing a lease agreement.

"Whatever the motivation, the lease agreement should represent the interests of both parties," Gerald Warmann says. "The final agreement between owner and operator should acknowledge the risky nature of agricultural enterprises."

A lease contract should be clear and concise, with details such as livestock description and identification, land use, stocking rates and turnout dates. At the same time, it should have sufficient flexibility in the terms and conditions to satisfy both parties.

Because a herd leasing arrangement involves a variety of economic, legal and business features, Warmann and Clark always advise producers to draft a written agreement rather than rely on a verbal agreement and hand shake. Most importantly, they ask the parties, "Where will you be in five years?" and, "What are your top goals?"

"Written agreements are more likely to be unambiguous in communicating the lease's objectives, terms and conditions," Warmann explains. "Hammering out a written agreement which addresses important issues requires that both parties communicate about all of these issues. Both parties' signatures on the agreement are proof that both know about and understand the terms and conditions of the lease itself. Conflicts are resolved and compromises are struck before the business deal is settled."

Last, but certainly not least, these ag economists recommend that the two parties get to know and understand each other, even if they are already acquainted.

"Would a bank make a loan without checking out the individual? No," Clark says. "A cow owner should take the same business-like approach."

The leasee will be caring for the leasor's cows. Reference checks with lenders, neighbors, former employers and teachers of the producer are important. The cow owner should know what kind of a stockman is caring for the cows. By the same token, the leasee should know the cow owner. What kind of manager is he or she? Is this owner known for fairness in dealing with others? Is the owner honest and trustworthy? What are his/her goals?

"The better the parties know and trust one another, the more smoothly the arrangement will work," Clark says. "Communication between the owner and leasee is one of the most important attributes of a successful agreement. Knowing and understanding each other will make communication much easier." AJ

Here's the Pros & Cons

Lease contracts can be a viable option. Still, no agricultural enterprise is risk-free. Here are a list of advantages, along with a few disadvantages, you should weigh in your mind before pursuing a cow lease/share agreement:

PROS

- Risks are shared.
- Operator uses capital without direct investment.
- Use of ooerator's available labor.
- Use of crop residues, pasture, facilities and equipment.
- Spreads sale or transfer of ownership over years.
- Investment income potential.
- Utilizes knowledge of both owner and operator.

CONS

- Control of assets and the enterprise may be shared.
- Requires more management, communication and records.
- May require more complicated business negotiations.
- May have variable investment income for owner.