Custom Farming: An Alternative to Leasing

Ag Decision Maker

File A3-15

Do you have the labor and machinery capacity to farm more acres, but do not want to lease more land? Would you like to reduce the financial risk exposure that you are carrying on leased crop land? Have you reached the payment limitation on one or more types of USDA commodity payments?

Are you a farm owner who does not want to invest in a full line of machinery? Are you fully employed away from the farm or retired?

An alternative to leasing farmland is custom farming. The custom operator agrees to perform all the machine operations on the owner's land in exchange for a set fee or rate. The landowner pays for all seed, chemicals, and other inputs, and keeps all of the crop and commodity payments.

One obvious advantage to the custom operator is that little or no additional operating capital is needed. Fuel, lubrication, and repairs are usually the only added costs. In addition, custom farming offers a fixed return. Although the possibility of higher repair bills poses some risk, this is minor compared with the price and yield risks faced by a tenant. In a good year, of course, profits from custom farming will be smaller than under a conventional lease, but this is a common trade-off for reducing risk.

Landowners find advantages to custom farming as well. Owners with small acreages can make most of the production and marketing decisions without investing in a full line of machinery. There are no lease payments to collect, since the owner receives all of the crop. The owner would usually be considered a material participant for tax purposes, and would be entitled to all government payments.

Responsibilities

Although the concept of a custom farming agreement is simple, close communication between operator and owner is essential. First, an accurate count of the number of acres to be farmed and their location should be agreed upon and recorded. Soil maps and field measurements available from the Farm Service Agency are helpful. A monitor on the planter can be used to estimate the number of tillable acres.

Second, the field operations to be performed need to be agreed upon. This will depend on the crop, field conditions, and conservation practices to be followed. The number and timing of operations can be left somewhat flexible, in order to adjust for varying weather and pest conditions. The agreement can specify how much freedom the custom operator has to modify the original plan, but communication with the owner is important. The operator may have the added responsibility to monitor weeds and insects throughout the summer, and suggest actions to combat them.

The type and amount of pesticides to apply also will vary. The owner generally has the final word, although the responsibility can be delegated to the custom operator. If the custom operator is responsible for purchasing supplies and having them delivered, the owner and operator can agree on additional compensation, such as a percentage markup over the cost of these supplies or payment for time and mileage expended.

Time of harvesting should be a mutual decision between owner and operator. The moisture level of the crop must be checked closely. If the custom operator also has crops to harvest, varieties with different maturities should be used, to avoid harvesting bottlenecks. Some contracts call for the custom operator to take charge of drying and handling grain into storage, as well. Even if this is done with the owner's equipment, the operator can be paid a fixed rate per bushel for managing the drying and storage facilities.

Contracts

In all cases it is advisable to prepare a written contract. This doesn't need to be an elaborate legal document. Simply discuss and record the important points. This can avoid misunderstandings later, and provide evidence of the nature of the agreement for income and estate tax purposes. For further clarification the contract can specify that the operator is an independent contractor, not an employee, partner, or tenant of the owner. This limits the liability of the landowner.

Timing of payments is negotiable, but many custom operators prefer to get paid at least twice a year, following spring operations and fall harvest. Summer weed control and hay harvesting operations may make a third payment desirable. The operator should submit a written itemized statement of work completed, dates, acres, and payment rates to the owner. The agreement may require payment to be made within a specified period after the statement is

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submitted. See Figure 1 for example.

Determining payments

Setting the payment rate may be the most difficult part of writing an agreement. *AgDM Information File, A3-10 Iowa Farm Custom Rate Survey* (FM 1698) reports average rates and ranges charged for custom farming and individual machine operations. Professional farm management firms also may be able to provide information about local custom rates.

Some contracts call for a single fixed rate per acre for all operations. However, many operators prefer to charge a separate rate for each operation performed. Many different combinations of tillage and weed control operations are possible. Conditions such as terraces, small and irregular fields, or special weed problems may justify a higher rate. Special factors such as timeliness, machine performance, and operator skill can command higher custom rates. Some operators prefer to charge by the hour for harvesting, mowing, and spraying weeds. Drying charges are usually based on the number of bushels handled, and hauling rates typically vary with distance, as well.

Incentive clauses, such as an extra 5 to 10 percent payment if crops are planted or harvested by a certain date, can be incorporated into an agreement. Bonuses based on actual yield also are used. However, the operator has no control over weather conditions that affect yields. Calculating the bonus by comparing actual yields to the county averages for the year would help compensate for some of the effects of the weather, although county average yield estimates are usually not available until several months after harvest. See Figure 2 for example.

Other considerations

Most custom operators inspect the land to be farmed before agreeing to a contract to check for field shape and size, terraces, ditches and waterways, rocks, drainage problems, weed infestations, and access to storage facilities.

Custom operators should check with their insurance agents about obtaining insurance coverage or bonding against damage to machinery or property while doing custom work. Some agents offer special policies for custom operators.

Operators should be realistic about how many acres they agree to farm. *AgDM Information File, A3-25 Fieldwork Days in Iowa* (FM 1874) shows how many suitable fieldwork days can be expected at different times of the year. Leaving several extra days for emergencies reduces the risk of late planting or harvesting. Timeliness is important for customer satisfaction.

Most contacts for obtaining custom work come about informally. Simply let people know you are looking for work, or for a custom operator. Professional farm managers can help match up owners and operators. Placing classified ads in newspapers and farm publications is useful. Some operators print up cards or flyers describing their services and post them in places frequented by farm owners, or incorporate them into a professional web site.

Custom operators need to know their own machinery and labor costs. However, the operator may not always be able to charge enough to cover all costs if others are willing and able to do the job for less. Over time, making the extra effort to do high quality work and to communicate regularly with the landowner will probably have more influence than price on the demand for the services of a custom operator.

. . . and justice for all

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Figure 1. Contract for custom farming for the year _____.

PARTIES

This contract is entered into by (name) _____

of (address) _____

contractor, and (name) _____

of (address) _____

owner, on (date)_____

DESCRIPTION OF FARM

The contractor agrees to perform custom farming operations for the owner on the following land or parcels of land: (include county, township, and section number) _____

_____

_____

_____

_____

METHOD OF PAYMENT

The contractor agrees to submit to the owner an itemized written statement of work completed after (date, or last operation to be completed)_____ and _____ .
The owner agrees to make payment to the contractor within _____ days after receiving the statement.

PROCUREMENT OF SUPPLIES

(describe who is responsible for the purchase and delivery of seed, fertilizer, chemicals and other supplies, and procedure for reimbursement, if any) _____

_____

_____

_____

OTHER PROVISIONS

(parties may wish to include language regarding bonus or incentive payments, contractor's right to subcontract, or __ owner's right to hire a different contractor) _____

_____

_____

_____

_____

_____

_____

Figure 2. Acres, field operations and rates[1/].

	Unit (acre, hr., bu.)	Rate per unit	Field 1 _____ ac.	Field 2 _____ ac.	Field 3 _____ ac.	Field 4 _____ ac.
Crop			_____	_____	_____	_____
Operation						
chop stalks	_____	_____	_____	_____	_____	_____
chisel plow	_____	_____	_____	_____	_____	_____
tandem disk	_____	_____	_____	_____	_____	_____
spray	_____	_____	_____	_____	_____	_____
field cultivate	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
plant	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
spray	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
combine corn	_____	_____	_____	_____	_____	_____
combine soybeans	_____	_____	_____	_____	_____	_____
dry grain	_____	_____	_____	_____	_____	_____
haul grain	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____

[1/] Fields may be described on page one of the contract, or on an attached map or description. Indicate with an X which operations are to be performed on each field. Several fields may be combined into the same column if the same operations will be performed on each of them.