Institute of Agriculture and Natural Resources
EC841

Beef Cow Share Lease Agreements

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Introduction

Cow-calf enterprises require large investments in capital, labor, and management. These capital investments in breeding livestock, facilities and equipment, feed, and other inputs can keep some individuals from being in cow-calf production. Capital investments are commonly shared among two or more people to reduce one person's capital requirements. A cattle share lease is one way to reduce an operator's capital needs. Typically, these leases provide the person caring for the cattle (operator) and the cow herd owner with a share of the revenue from the calf-crop sale in proportion to the expenses each person contributes. This publication discusses guidelines to consider when establishing a cattle share lease arrangement.

The Common Cattle Share

A **share rental** arrangement is more common than a **cash rental** arrangement. Rather than the operator paying a set fee to the cattle owner for the use of the breeding herd (cash lease), a share lease divides the calf crop between the operator and owner based on what each person contributes to the production of the calves. The operator typically supplies land, labor, some of the management, and other inputs. The major economic difference between a cash lease and a share lease is that a cash lease "rents" the cows for a set cash price for a period of time, whereas a share lease guarantees each person a portion of the year's calf crop. These lease agreements differ as to which person bears risk. In a share lease agreement, the cattle owner receives a share of the calf crop and therefore shares both the production and price risk with the operator. In a cash lease, the operator is usually bearing the production risk.

Advantages of a Cattle Share Lease for Cattle Owners (Lessor)

- Continued investment in a cow herd versus selling
- Retained ownership in a cow herd with reduced labor, management and price risk
- Opportunity for transfer of cow herd ownership over an extended period of time

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Advantages of a Cattle Share Lease for Cattle Operators (Lessee)

- Reduced capital investment (beginning operator wanting to expand)
- Shared production, price risk and management with the opportunity to gain experience
- Opportunity for gradually acquiring ownership of the cow herd

Points to consider when creating a cattle share lease:

- Terms should provide that "individual investment equals compensation."
- Keep it simple. This will make it easier for both parties to uphold the agreement.
- Flexibility is important. Change in production, market, and management practices need to be addressed as they arise.
- Situations are often unique. Develop a lease that best fits the needs of both parties.
- Put the lease in writing and clearly define terms and expectations. A written lease provides clarification for both the cattle owner and the operator.

Sharing Revenues and Costs

The two parties in the lease arrangement must decide how revenue from the sale of cattle will be divided and who will pay for costs such as feed, veterinary supplies and services, pasture and winter grazing costs, utilities, etc. The responsibilities and contributions of management and labor must be accounted for in the cost estimation. Allocation of expenses should play a key role in determining the percentage split of the calf crop revenue that each party should receive. By sharing revenue in proportion to the share of contributions incurred, the lease arrangement is likely to be "fair" for both the operator and the cattle owner. An electronic spreadsheet that uses an enterprise budget can be a helpful tool for making this determination. The University of Nebraska has developed a spreadsheet that can be used in this process.

Cow-calf Share Lease Cow-Q-Lator Decision Aid

The downloadable Excel®-based decision aid tool titled "Cow-calf Share Decision Aid" can be helpful in determining what an equitable share lease or cash lease arrangement would be. This spreadsheet, found at www.agmanagerstools.com, prompts the user to enter all inputs that both the operator and owner would be contributing to the production of weaned calves. The worksheet can then be used to calculate both a cash lease value or a percentage share of the calf crop. This decision aid is designed to assist both parties in understanding the value of contributions and determine an equitable agreement.

Things to Consider Before Finalizing a Cattle Share Lease

Although determining the proportion of expenses and revenue to be shared by the operator and cattle owner can be complex, it is important to keep leasing arrangements as simple as possible. The following topics are included as a help in building a lease agreement.

1.) **Make sure the arrangement is equitable.** It is important that all parties feel adequately compensated for what they contribute. To ensure each party is treated equitably, revenue should be divided proportionately to the contributions that were made. Research and effort from both the operator and cattle owner, along with a nonbiased third party, can be used to determine what an equitable agreement is.

2.) **Goals for both parties need to be compatible.** Cattle owners and operators who have not worked together previously should clearly outline the goals of the share lease agreement. A one-year lease may be considered, as it allows the terms of the lease to be revised annually if needed, or the share lease relationship can be dissolved. A multiyear lease also has its benefits, allowing a relationship to develop between both parties. However, a multiyear makes it difficult to terminate prior to the ending of the lease if issues arise. Therefore, it is common to find parties who write a one-year lease and renew the contract annually. The flexibility in making adjustments each year due to unforeseen situations is advantageous in a share lease agreement.

3.) **Know the financial situation of the other party.** It is important that both the cattle owner and operator have an understanding of the other's financial position. Individuals signing the lease should feel confident that the other person can financially fulfill contractual obligations. Obtaining a credit reference from a third party (e.g., bank) may be appropriate to determine the financial soundness of the other person. Have a plan outlined in the lease that shows steps that will be taken if one party becomes insolvent, or if circumstances call for ending the contract.

4.) **Dividing the calf crop equitably.** There are a number of ways calves can be divided equitably. The objective is that both parties get a share of the calf crop that will generate revenue proportional to the costs and the risk that each incurred. The most common ways will be discussed.

A.) **Percentage Share Lease** — The most straight forward way of dividing the calf crop fairly is to divide the calves in proportion to what each party contributed. For example, a 70-30 share lease implies that the cattle owner will receive 30 percent of the weaned calves (or revenue from their sale) for providing 30 percent of the total production costs. By using this method, both price and production risks are shared between the parties. These leases are the most straightforward way to share the calf crop and the easiest to equitably adapt to the proportional contribution made by each party.

B.) **Fixed Number of Calves Lease** — In this method, the calf crop is divided based upon a minimum guaranteed number of calves to the cow owner. For instance, a lease may require that the cow owner receive a minimum of 30 calves per 100 cows leased. Assuming a 90 percent calf crop, this equates to a 67-33 share lease agreement. The cow owner will receive 33 percent of the calves when the calf crop percentage exceeds 90 head of calves weaned per 100 cows leased. In this example, the operator assumes all of the risk if the calf crop weaned falls below 90 percent. If out of 100 cows only 80 calves are weaned, the cow herd owner still receives 30 calves. With 30 of the 80 calves going to the cow owner, the cow owner is receiving nearly 38 percent of the calves weaned but only paying 33 percent of the total costs. The operator is getting 50 of the weaned calves or approximately 62 percent of the calf crop even though the operator had contributed 67 percent of the costs. Fixed calf leases place all the production risks on the operator when the calf crop percentage weaned falls below some agreed upon level.

5.) **Physically dividing the calf crop.** The method to divide the calf crop should be included in the lease agreement and should specify the sex of the animals to account for revenue differences in the sale of heifers and steers. Examples of calf crop splits are listed below.

A) Sell calves at weaning and divide revenue based on prespecified shares.

B) In a 67-33 lease, divide all calves into three groups (with an equal number of heifers and steers in each group). The cattle owner then could pick his or her desired group first.

C) State that the cow owner's share will be the result of an equal split of steers and heifers from a random sort of weaned calves.

Agreements for dividing calves should take into account potential weight and value differences of calves to ensure both parties are receiving a fair portion of the value of calves produced. A lease agreement should clearly state how a price will be determined if either the cow owner or operator wants to purchase the other party's calves.

6.) **Death loss of cows.** Another detail that should be included is how to prove to the cow owner that a cow has died. Pictures, part of the hide containing the brand of the dead cow or a certificate/receipt of proof from a rendering company are commonly used to prove the death loss. Lease agreements should include a plan for addressing how excessive death loss, beyond some agreed upon value, will be handled.

7.) **Cattle care and health responsibilities.** Cow owners should be confident that their breeding herd will be properly cared for and fed when the operator is responsible for the care of the cattle. Because leases are different and the obligations can vary for each party, it is important that one of the largest obligations, caring for the cattle, is specified clearly in the lease as to the type and amount of care. Identifying a veterinarian who will be involved in developing a herd health plan and consulted for cattle health and treatment needs should be done when entering into the lease agreement.

8.) **Bulls, replacement bred heifers, or bred cows.** How replacement breeding stock will be handled should be specified in the contract. The cow owner usually receives the income from the cull cattle; thus it is most common for the cow owner to be responsible for supplying replacement stock (bulls, bred heifers, or bred cows). Replacement heifers could be taken from the cow owner's share of the calf crop, in which case the cow owner may negotiate for a higher proportion of heifer calves. If, however, ownership of the herd is being transferred to the operator, it may be the operator's responsibility to provide replacement heifers and bulls. It is important that an expected replacement rate be spelled out in the lease agreement and expected age and quality of replacement cattle be defined. If the cow owner requests that the operator develop replacement heifers, it may be best to have an agreement for replacement development that is separate from the basic share agreement. Including heifer development into the share arrangement complicates the contract and makes determining an equitable lease more difficult.

9.) **Determining which cows to cull.** The owner of the cattle frequently decides which cows are to be culled from the herd. This issue should be discussed and included in the written lease. Expected cull and replacement rates should be outlined in the contract. Deciding which cows to cull and when may best be a joint decision between the cow owner and operator.

10.) **Lease agreements as a method to transfer herd ownership.** A share lease agreement can be a good way to transfer ownership of the cow herd from the cow herd owner to the operator over time. This arrangement can be beneficial to both parties. The cow herd owner may find it advantageous from a tax standpoint, and the operator may find it easier to cash flow and reduce borrowed capital. Since all cattle will eventually leave the breeding herd, they can be replaced completely or in part by the operator, gradually transferring ownership. The cow owner would receive income from the sale of owned cull cows and also receive a percentage of the calf crop based on the number of cows owned in the herd. For example, if the herd consisted of 100 cows and 10 cows are culled each year, the cow owner would own 90 cows at the beginning of the second year. If the lease originally involved a 50-50 split, then in the following year the owner would receive 50 percent of the calves from 90 cows. As time passes, the proportion of the herd owned would be reduced until the original cow herd owner no longer had an ownership interest.

11.) **Be aware of tax or social security concerns that may arise from a lease arrangement.** Cow herd owners who have retired from their own farming/ranching operation but who are still active in the cattle share lease are said to have material participation. Income received from material participation in the cow enterprise could have tax implications (cow herd owners should consult their tax preparer).

12.) **Marketing decision responsibility.** Marketing responsibility should be defined as part of the lease agreement. Joint marketing decisions could be an advantage for both parties, depending on the experience of the operator and cow herd owner. For example, an experienced owner or operator could help the other party understand and make good marketing decisions. By pooling resources and knowledge, both parties may be able to improve the overall price received. Because use of marketing tools can greatly reduce unnecessary price risks when used properly or can increase price risk if used improperly, it has potential to be an area of dispute. A written lease can reduce these disputes if it clearly outlines marketing and price risk decision-making responsibilities.

Cattle Share Lease Checklist

To avoid problems or disputes between cattle owners and operators, lease agreements should include these minimum requirements:

- Put the lease in writing. A written agreement can be used in court if necessary or as a reference if clarification is needed by either party.
- The lease should cover all obligations of both parties, including those of death loss of livestock and termination of the contract (termination may be due to the death of one of the parties). By including all obligations, the parties will reduce problems and concerns that may arise and help maintain a good working relationship.
- The lease should be signed by both parties and include an address of those parties.
- The time period of the lease should be specified.
- An accurate legal description of the property involved with the agreement should be included.
- The amount, dates, and location of the payment should be clearly defined.
- It is vital that both parties understand all terms of the lease and that they agree with it. If either party does not understand or is not comfortable with any part of the lease, it should be discussed and the issue resolved before the lease is signed.

Special note: *The examples and terms described in this publication are designed to provide cattle owners and operators an understanding of beef cattle leases and the advantages and disadvantages of share rental arrangements. All parties entering into the lease must agree upon terms that will allow both parties to sustain a sufficient income for their investments. Changes and variation in agreements are likely and should be expected. The examples are for illustrative purposes and educational use only. The contents of this article are intended for general informational purposes and should not be construed as legal advice. Readers are urged not to act upon the information contained in this article without first consulting an attorney.*

Acknowledgment

Rebecca M. Small, former extension assistant; Darrell R. Mark, former extension livestock marketing specialist; Richard T. Clark, professor emeritus, Department of Agricultural Economics, and David J. Goeller, farm business management specialist, contributed to the original preparation of this publication.

Sample Cattle Share Lease

The following is a sample lease. Many of the topics discussed in this publication are outlined in the following lease. It is important to understand that this is only a sample and it is necessary to develop a lease that is unique to individual situations.

This agreement is made and entered into this _______ day of ____________, 20____ by and between the following parties:

Cow Owner (lessor): ____

Ranch/Operator (lessee): ____

I. Operator desires to lease from the Owner ________ head of _______________ (type of livestock) from ______________ (date) to _______________ (date). During the term of this lease the Operator agrees to take custody of said livestock, to properly breed, graze, pasture, feed, maintain, and care for the same, and to raise the calves produced thereof and therefrom, all at Operator's expense. This agreement shall automatically renew for succeeding one-year periods if neither party gives notice of termination within _______ days of expiration of this Agreement. Such renewal shall be noted at the end of this Agreement by noting the year of renewal, the initial number of cows, and the signature of both parties signifying acceptance of the renewal terms as well as acceptance of all other terms and conditions contained within this entire Agreement. (This lease may also expire if the lease is under the terms of a transfer from Owner to Operator, and the Owner's share of the cow herd has decreased to zero.)

II. Any barren, open, or unproductive cows will, at Owner's option, be returned to Owner or delivered to the sale barn of Owner's choice for sale. Thereupon Owner shall have the option to replace any such barren, open, or nonproductive cows during the term of this Agreement with replacement cows, which have been bred or are suitable for breeding. Owner shall have the right to place additional stock cows in the custody of Operator under the terms, conditions, and covenants of this Agreement upon the consent of Operator.

III. Division of the calves. Operator is to receive 70 percent of the calves and Owner is to receive 30 percent of the calves. Unless otherwise mutually agreed, the calves will be split with a gate cut. The Owner receives the first 30 percent of calves that walk through the gate. Division of calves is to be done annually or more frequently if necessary and mutually agreed. It is mutually agreed that the division is to be done at weaning time, when the calves are at an age of approximately six months or a weight of approximately 400 pounds. Division may also be done when calves are to be sold.

IV. Operator agrees that all fences, corrals, enclosures, sheds, and such shall be kept in good repair and that they will retain the cattle. Operator also agrees that all corrals, lots, and pastures shall be kept free of debris, trash, and other objects that could be reasonably assumed to be harmful to cattle.

V. In the event of the death of an animal owned by the Owner while in possession of the Operator, Operator agrees to present to Owner a picture(s) of the deceased animal with identification, that portion of the hide containing the brand or a certificate from the rendering company stating the brand on the deceased animal. In any event, Operator agrees to notify Owner in writing of any death, emergency, or unusual event as soon as possible.

VI. Owner and Operator shall share in any loss as a result of death of any calf or calves up to 10 percent of the increase from said cows; any loss in excess of 10 percent shall be borne exclusively by Operator so that Owner will be guaranteed a minimum 30 percent of remaining calf crop from said cows each year.

VII. Operator agrees to allow Owner to inspect the cattle at reasonable times. Operator further agrees to keep Owner informed as to the location of the cattle.

VIII. Operator agrees that if cattle are returned to the Owner prior to the expiration date of this Agreement or any extension thereof, (s)he shall pay Owner the sum of $ _____________ per month per head, which amount is agreed to be reasonable cost of feed per month per head.

Owner ______________________________________ Phone ____________________

Address ____

Operator ______________________________________ Phone ____________________

Address ____