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# Land Contracts for Beginning Farmers

Edward Cox  
*Drake University*

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# Land Contracts for Beginning Farmers

## **Abstract**

The brochure was developed as part of the Sustainable Agricultural Land Tenure Initiative, and provides an introduction to land contracts, which have been used in recent years by operators who lack large amounts of capital and access to financing from lending institutions. The brochure outlines advantages and risks, and lists contacts for further information.

## **Disciplines**

Agriculture | Agriculture Law

farmer land access by enabling landowners to provide lower interest rates on land contracts. The program does not guarantee contract payments and the specific terms of the contract are decided by the parties.

Beginning farmers must meet eligibility requirements established by both IRS regulations and state agricultural development authorities relating to their farming experience, relationship to the landowner, net worth, amount of land already owned, and ability to repay the loan. Further details can be gathered from the contacts provided below.

**The Land Contract Guarantee Program** from USDA Farm Service Agency (FSA) offers two types of guarantees, available at the request of the vendor. First, is the “prompt payment guarantee.” This guarantee covers up to the amount of three amortized annual installments or three annual installments plus the cost of any related real estate taxes and insurance. Second, the “standard guarantee plan” covers an amount equal to 90 percent of the outstanding principal of the loan.

Its important to note that while this program allows landowners to opt for a guaranteed payment in case of default, it does not protect beginning farmers from forfeiture. However, as opposed to the Aggie Bond program, the Guarantee Program does require certain contract terms, including a 5% down payment, amortization of contract payments for the first twenty years, and a fixed interest rate not exceeding three percentage points above the FSA’s direct ownership loan interest rate.

Additional information, eligibility standards, and applications can be obtained from Local USDA Service Centers.

#### VI. HELPFUL CONTACTS

**The National Council of State Agricultural Finance Programs** provides a list of contacts for states participating in the Aggie Bond program. They can be found at [www.stateagfinance.org](http://www.stateagfinance.org).

**Your Local USDA Service Center** can provide more information on the LC Guarantee Program. A directory of Centers is located at [www.nrcs.usda.gov/wps/portal/nrcs/main/national/contact/local](http://www.nrcs.usda.gov/wps/portal/nrcs/main/national/contact/local) or by calling (202) 720-2791.

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LEOPOLD CENTER

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The Drake Agricultural Law Center is internationally recognized for providing opportunities to study how the legal system shapes our food system and influences the ability of the agricultural sector to produce, market and utilize agricultural products.

#### CONTACT INFORMATION

DRAKE AGRICULTURAL LAW CENTER  
2621 CARPENTER AVENUE  
DES MOINES, IOWA 50311  
(515) 271-2205  
EDWARD.COX@DRAKE.EDU  
[www.law.drake.edu/aglaw/](http://www.law.drake.edu/aglaw/)

# LAND CONTRACTS FOR BEGINNING FARMERS

## A DRAKE AG LAW PRIMER



#### LESSON PLAN

- I. Introduction to Land Contracts
- II. Typical Land Contract Provisions
- III. The Advantages
- IV. The Risks
- V. Land Contract Incentive Programs
- VI. Helpful Contacts

## I. INTRODUCTION TO LAND CONTRACTS

Land contracts, also referred to as installment land contracts, contracts for deed, and land sale contracts, are sales transactions in which the vendee (the buyer) makes a down payment followed by periodic payments, with interest, and the vendor (the seller) retains title to the property until all payments have been made.

During the contract, the buyer is considered to have equitable title to the land. This means they have the right to possess, use, and dispose of the property and the right to exclude others from the land, except as provisions in the contract may dictate. Buyers, however, also accept the landowner responsibilities, including paying taxes, maintaining insurance, and making repairs. The seller retains legal title to the property until the final payment, or an agreed upon amount, is paid.

The popularity of land contracts as a method of land transition has waned in popularity over the last few decades, but it does continue to hold appeal for certain operator demographics, particularly those lacking large amounts of capital and access to financing from lending institutions. The use of land contracts to enable land access for beginning farmers are also promoted through incentive programs at the state and federal level. If considering such an arrangement, both landowner and farmer should understand the advantages, risks, and potential legal consequences of entering a land contract.

## II. LAND CONTRACT PROVISIONS

As a contract the buyer and seller are, in large part, free to establish the rights and obligations of each party within the terms of the agreement itself.

**Typical provisions** require the buyer to make specified payment amounts at particular times or intervals, to pay taxes and assessments, and to maintain insurance on the premises. The seller is required to convey the property to the buyer, usually through a warranty deed, and to provide an abstract showing good title at the time of contract formation.

**The forfeiture clause**, a principal feature of land contracts, allows the seller to terminate the contract, regain possession, and retain the buyer's prior payments if the seller defaults on the contract. This clause and other terms relating to default are discussed further in "The Risks" section.

**A due on sale clause** requires payment in full if the buyer sells their interest in the property. If financing is unavailable to fulfill this term, a beginning farmer's ability to cut their losses if unsuccessful is limited.

**Prohibitions against early payments** are common if sellers are using the contract payments as retirement income. This limits a farmer's opportunity to decrease the total interest they will pay.

## III. THE ADVANTAGES

**For the buyer**, the primary advantage is acquiring land they wouldn't otherwise be able to finance. This is available, in large part, due to:

- lower down payments,
- fewer closing costs, and
- the lack of standardized application and underwriting processes that may not take niche and local marketing into account—strategies particularly important for beginning farmers.

**For the seller**, advantages include:

- steady income for the duration of the contract,
- interest earned on the financing, and
- distribution of tax liability over several years.

As mentioned, the seller retains legal title to the property, providing some security in case of default.

## IV. THE RISKS

**The risk for buyers is forfeiture**, which, as discussed previously, results in the loss of the property along with any equity and improvements made. This clause can have a devastating effect on any buyers, particularly those who have acquired substantial equity or put a great deal of labor and expense into improving the land and facilities, which is a common occurrence for beginning farmers.

**Legal protections against forfeiture** depend on state law. The majority of states impose a mandatory grace period. For example, Iowa requires sellers to provide notice of forfeiture, specifying the violation and giving 30 days to fix it. Some states provide additional protection if a residence is involved. In Ohio, sellers may have to use judicial foreclosure to regain possession if the property has been improved with a residence, the contract has been in effect for 5 years or more, and 20% or more of the principal has been paid. A few states have eliminated forfeiture as a remedy altogether. Oklahoma and

Kentucky subject land contracts to the same foreclosure requirements as a mortgage.

**Contractual protections against forfeiture** can also be considered. As mentioned previously, the parties are free to agree to the terms they see fit. Therefore, even if not required by state law, the contract itself can require a grace period, a foreclosure process, or other safeguard.

Farmers can also mitigate losses due to a forfeiture by requiring reimbursement for the non-depreciated value of attached improvements. Sellers, in turn, will likely want to include provisions requiring permission before improvements, for which they may be obligated to provide reimbursement, can be constructed. Contract terms can also provide clarification of ownership and the right to remove more mobile improvements, such as hoop houses.

**The principal risk for the seller** is, of course, that the buyer may not pay. Landowners may be particularly worried about this risk in relation to beginning farmers. However, as discussed above, sellers often have the remedy of forfeiture, a very powerful tool that greatly reduces a seller's risk. Where forfeiture is not available, the USDA Guarantee Incentive program discussed below may be particularly beneficial.

Its important to note, the right of forfeiture does not completely reduce a seller's risk and can actually create a loss for the seller as well. For instance, in the 1980s many retired farmers that sold land on contract just prior to the farm crisis, were stuck without income because their buyers couldn't pay and, after forfeiture, owning land with drastically reduced market value. These circumstances are rare but still worth consideration. Again, the USDA Guarantee Program may be helpful in such situations.

## V. LAND CONTRACT INCENTIVE PROGRAMS

Government programs exist at both the state and federal level. These programs provide incentives to landowners to enter land contracts with beginning farmers. The availability and impact of the incentives is dependent on state law.

**The Aggie Bond program** is a state-federal partnership that provides a landowner a federal tax exemption for interest income on land contract payments. Some states, such as Iowa and Missouri, also exempt interest from state income taxes. This is intended to promote beginning