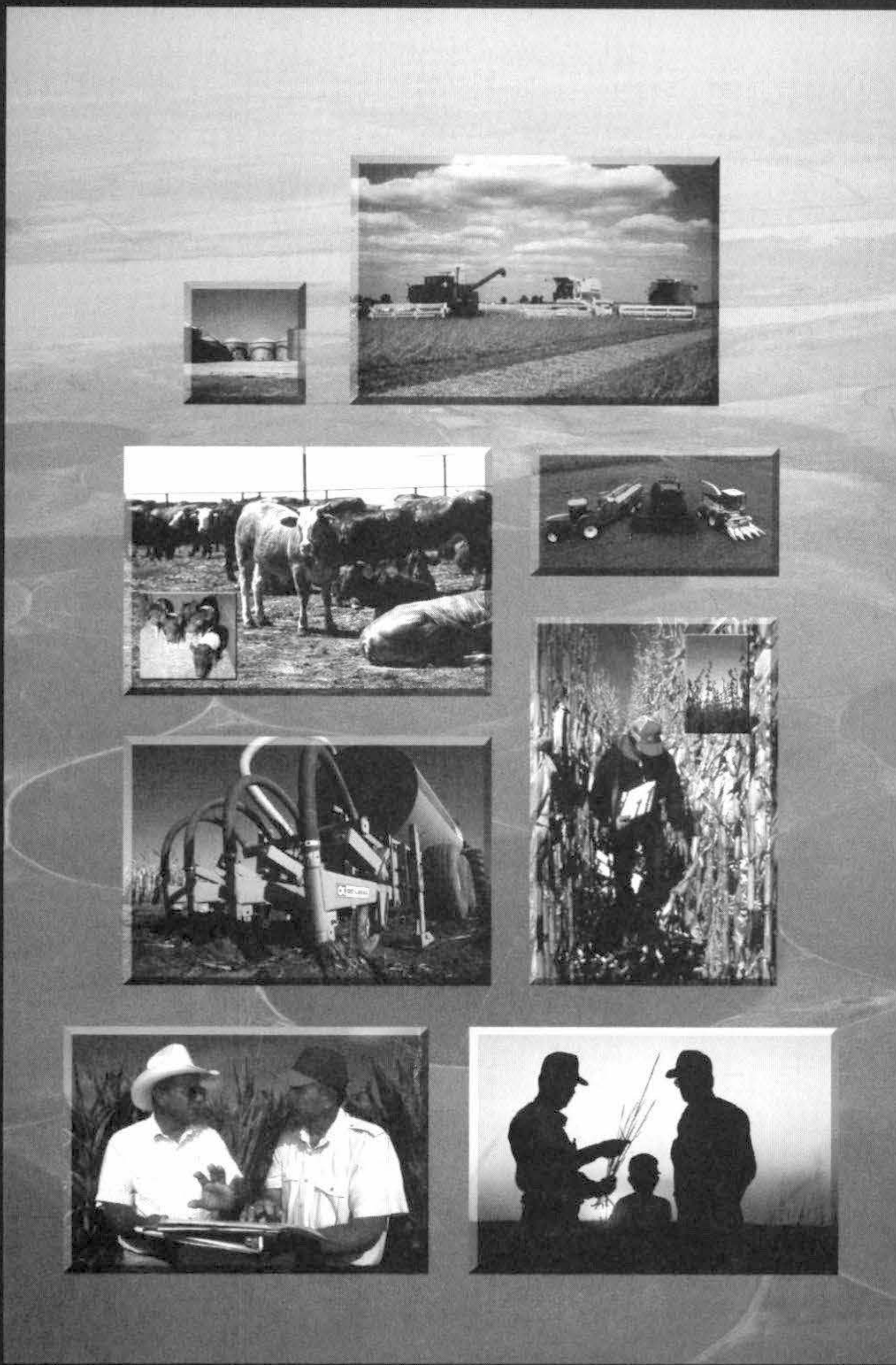
Acquiring and Managing Resources for the Farm Business

Part IV in the **6** part series:

Business Management for Farmers



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Acquiring and Managing Resources for the Farm Business

Part IV in the **6** part series:

Business Management for Farmers

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About the author

Kenneth H. Thomas was an extension economist in Farm Management at the University of Minnesota from 1959 to 1992. That this was a very dynamic period in U.S. agriculture is reflected in the wide range of management issues he worked on and wrote about.

During the 1960s and early 1970s he was very involved in helping farm families develop longer range plans for their businesses. In 1973, he coauthored a North Central Region publication that integrated profitability and financial soundness aspects into business planning and analysis.

Beginning in the mid-1970s he began working in, and writing about, land rental arrangements and the buying and selling of farmland. He also began working in the areas of getting started in farming, business arrangements, and farm estate planning and transfers, coauthoring four regional bulletins on these topics.

As businesses became larger, he began working on personnel management issues and coauthored a regional bulletin on farm personnel management. He also team-taught an agricultural law course at the University of Minnesota, which led to the inclusion of a number of the legal aspects in this series.

As a capstone of his career and as a transition into retirement, he began writing this six-part series, *Business Management for Farmers*. It is his hope that this six year "labor of love" will prove helpful to present and future generations of farmers.

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Preface

More farmers fail because the size of farm or kind of farming does not keep men, horses, and machinery properly employed than fail because of poor crops.

–George Warren in his book, *Farm Management*, 1913.[1]

About the series

This publication is the fourth in a six-part series written for, and dedicated to, farm operators and managers in the U.S. Parts I, II, III and IV deal with managing an established farm business. Part V focuses on the issue of getting established in farming, while Part VI deals with planning the late career/retirement years. The series should prove useful not only to managers, but to educators, lenders, consultants and others, including persons considering farming as a career. **A list of chapter titles for the other parts in the series is on the inside back cover of this publication.**

Part I, *Developing a Longer Range Strategic Farm Business Plan*, first provides an introduction to the planning process. It then covers evaluating a present business situation and setting tentative life-style and business goals. This is followed by a discussion of the development of a longer range business plan. Information is then provided on how to develop, gain acceptance of, and implement a workable transition plan. Restructuring and/or liquidation of a financially stressed farm business are also addressed.

Part II, *Managing the Overall Business*, is divided into three sections. Section I focuses on people skills and legal aspects. Section II discusses financial management including financial planning, security agreements, income tax management, and the use of insurance. Section III discusses the development and/or updating of business arrangements and retirement and estate plans.

Part III, *Managing Crop and Livestock Systems*, discusses production and marketing, and the use of production contracts.

Part V, *Getting Established In Farming*, discusses whether one should consider farming as a career, whether to farm together; starting farming via multi-owner/operator route or partly or mostly on one's own.

Part VI, *Planning the Late-Career, Retirement Years*, focuses on life-style planning, financial security, and the transfer of farm assets.

About Part IV

This part, Part IV, focuses on one of the most challenging aspects of today's farm manager's job: the acquisition and management of resources.

The first two chapters deal with the acquisition of farm real estate. Chapter 1 focuses on renting farmland and facilities. Issues include selecting the type of lease arrangement, developing economically fair leases, having sound written lease arrangements, and keeping appropriate records. Chapter 2 deals with the purchase of farm real estate, including the analysis of possible purchases, and financing such purchases via a mortgage or contract for deed arrangement.

Chapter 3 focuses on managing the machinery system. Topics include developing machinery cost budgets, making individual machine and system-wide decisions, deciding how to acquire the use of machinery services, and keeping appropriate records.

Chapters 4 and 5 focus on farm personnel management. Chapter 4 deals with planning and staffing issues. This includes determining staffing needs as well as recruiting and selecting new employees. Chapter 5 focuses on various aspects involved in managing a work force. This includes carrying out various responsibilities in managing employees effectively, as well as compliance with various laws and regulations.

1. **Special Note**: *Farm Management*, by George F. Warren, Macmillan Co, 1913, was one of the earliest books written on this subject. Dr. Warren's son, Stanley, taught Farm Management at Cornell University for 42 years. His teaching excellence and mentoring resulted in the author of this series choosing farm management as a career.

Acknowledgments

The author wishes to extend gratitude to several people and organizations for their help. They include:

- Paul Brutlag, attorney/farm operator from Elbow Lake, MN for his help in developing the segment on financing farm real estate (Chapter 2) and helpful suggestions in the development of the chapter on machinery (Chapter 3).
- Dr. William Edwards of Iowa State University for permission to use portions of his machinery publications and review of the chapter on machinery (Chapter 3); and to Dr. Bernard Erven of The Ohio State University for his help as coauthor of NCR publication 329, Farm Personnel Management (1989). Portions of that publication were used in developing Chapters 4 and 5.
- Richard O. Hawkins, Professor Emeritus, University of Minnesota, for his review and suggestions for all parts of the series. Thanks also to the Center for Farm Financial Management at the University of Minnesota for providing secretarial support for this project.

Finally, the author wishes to thank the North Central Farm Management Extension Committee for their support of this series. Thanks also to the staff at MidWest Plan Service for their expertise editing and designing this publication.

Renting farmland and facilities

1

- Selecting the type of cropland lease agreement
- Developing economically fair arrangements
- Written lease requirements; basic elements; special provisions
- Records for monitoring and adjusting land rental arrangements; for reporting purposes
- Selecting and keeping a good farm operator; a good landowner

Much of Midwest farmland is operated under some type of rental agreement. This chapter focuses on selecting a rental arrangement for a given situation, developing economically fair leases, and putting them in writing. This chapter also covers the records needed to monitor and adjust these arrangements, and for reporting purposes. The chapter closes with some tips on selecting and keeping a good farm operator and landowner.

Selecting the type of cropland lease arrangement

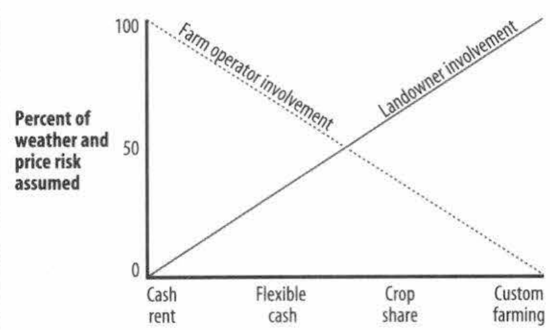
Two types of cropland lease arrangements are most common: the cash lease and the crop share lease. Following is a description of their general characteristics and the advantages of each type.

General characteristics: Risk and landowner's involvement

The degree of risk and degree of landowner involvement are key considerations when deciding whether to cash rent or crop share a farm or parcel. Farmers face greater risks now than in the past because of increased business size, increased use of credit, and increased dependence upon world markets, which often result in more variable prices. Of course, the traditional risks of weather, disease and pests still remain. Thus, in selecting and adjusting rental agreements, all parties need to recognize the amount and type of risk the farm operator and landowner assume.

As shown in Figure 1-1, cash rent involves the greatest amount of risk for the farm operator. At the other extreme, with custom farming, the landowner assumes practically all of the risk. Crop share leases involve varying degrees of risk for both the operator and the landowner depending on the arrangement.

Figure 1-1. Risk associated with selected farm land rental arrangements.



The kind of lease selected often reflects the desire of the farm operator and/or landowner to assume more or less risk. For example, a landowner unwilling to expose his/her income to price and weather variations normally will opt for cash rent. On the other hand, crop share leases usually involve greater risk to the landowner and require a closer working relationship between the farm operator and landowner than with cash rental agreements.

A crop share lease is more apt to meet the "material participation" test for earnings eligible for social security coverage than is a cash rent lease. As a result, landowners prior to their retirement may prefer the crop share lease. After retirement, however, this same test has prompted many landowners to shift to cash rent agreements so that social security payments are not reduced (cash rent income is treated as unearned income and, thus, not subject to social security tax).

Landowners who hire all field operations done, i.e. custom farming, bear production and price risks on 100% of the crops being produced. They usually become involved in custom farming because they may have small tracts of land and/or insufficient equipment. However, some individuals choose custom farming because of the satisfaction they receive (or expect to receive) from staying closely involved in farming-even though they don't do the work.

Farm operators' preference in rental arrangements may reflect a desire to shift some price and production risk to landowners under crop share leases, especially in areas of high crop yield variability. Beginning farmers also may prefer crop share arrangements in order to reduce the amount of financing required for crops inputs, and to share price and production risks with the landowner. Other farm operators may feel most comfortable operating with a cash lease because it allows them more freedom in the planning and operation of their farm business.

Table 1-1 shows the degree of landowner involvement under various rental arrangements. These rankings may prove helpful in selecting or changing one's rental agreement.

Comparing the advantages of cash and crop share leases

Table 1-2 summarizes the advantages of cash and crop share leases from both a landowner's and a farm operator's point of view.

Table 1-1. Landowner involvement under various cropland rental arrangements.[a]

	Method of operation			
	Cash rent			
	Fixed	Flexible	Crop share	Custom operated
Capital required:				
machinery & equipment	none	none	low	low
operating expense	none	none	mod	high
Management involvement	none	none	mod	high
Market responsibility	none	none	mod	high
Risk assumed	low	low-mod	mod	high
Variability in returns	none	low	mod	high
Material participation	not usually	not usually	varies	yes

[a] Adapted from *Fixed And Flexible Cash Rental Arrangements For Your Farm,* North Central Regional Extension Publication 75.

Table 1-2. Comparing cash leases with crop share leases.

Cash lease	Crop share lease
Landowner	**Landowner**
Less management input	More management input
Less potential for disagreements	Sale of crops/purchase of inputs permit more tax management options
No concern over accurate division of crops, expenses	Share in higher yields and prices
Don't have to market the crop	Can build up social security and ensure current use value eligibility for estate tax purposes
Assured income; price, cost, and yield risks assumed by farm operator	
Farm operator	**Farm operator**
Free hand in decisions	Less price and yield risks
Less chance for disagreements	Less operating capital required
More incentive to strive for higher yields	Share expenses, no prepaid rent
Don't have to share excess profits due to higher prices or yields	
No concern over accurate division of crops, expenses	

Developing economically fair arrangements

The two most common methods of renting farmland and facilities are cash and share. Either method must be economically fair to both the farm operator and the landowner otherwise continuing the arrangement over a period of years is highly unlikely. Following is a discussion of the process of developing economically fair cash and crop share arrangements.

Developing a fair cash rental arrangement

The cash farm lease is the simplest lease arrangement. It involves a cash payment of either a specified sum or an amount determined by formula in exchange for the use of land. This arrangement gives the farm operator the greatest operational flexibility and potential for the greatest gain in years of good prices and yields. Therefore, the established farmer usually prefers this arrangement. However, the cash lease also has the potential for the greatest loss, such as that which often occurs during years of drought or excessive rainfall. As a result, the cash rent approach is not as desirable for the beginning farmer. Nor is it good for the strictly tenant operator who does not own land over which to spread crop loss risks, or who is not permitted to assume that degree of risk by a lender.

Methods of determining a fair cash rent

One of the key tasks in using the cash rent approach is to arrive at a fair cash rent for the parcel or farm in question. There are three methods for determining a fair cash rent for a given piece of land:

- Market data approach.
- Landowner's desired return approach.
- Farm operator's "How much can I afford to pay?" approach.

Market data approach: The landowner and the farm operator need to determine the rent of comparable farms in the area. This is often difficult to do, particularly if land values and rents are changing rapidly, and/or in selected areas where specialty crops, e.g. sugar beets, or conservation reserve programs are distorting the local rental market. In any case, farm operators must recognize that they are not going to rent much land if they are bidding considerably below the going rate in the area. Similarly, landowners will have a problem if they ask for rents that are considerably above local rental rates.

Landowner's desired cash return approach: Landowners can use the procedure detailed in Worksheet 1-1 for estimating the rent required to provide a desired return on investment and to cover other cash expenses associated with ownership. The acreage amount shown at line (2) should be in **tillable acres**, to be comparable to the rent calculated by a farm operator later in Worksheet 1-2.

Use a **real interest charge** (interest rate - expected inflation rate) of 6% to 8%, as a desired return on investment charge. Adding other cash expenses associated with the property will likely bring the desired cash rent to 8% to 10% of the fair market value of the property. (Worksheet 1-1 works out to 8.6%.) This percentage will vary by areas and also over time, due to the interplay between land prices and land rents. For example, in the early 1980s this ratio was in the 4% to 6% range; by the mid-1980s the ratio was in the 10% range.

Farm operator's "How much cash rent can I afford to pay?" approach: Worksheet 1-2 is designed to help a farm operator determine how much cash rent he/she can afford to pay for a given piece of property while still covering selected costs and with possible variations in crop income. Estimating overhead charges must account for longer term expenses, and estimates need to provide for the cost of machinery replacement, payment of a reasonable wage for labor, and for management and risk. Computer programs are available to calculate estimates. In Minnesota, the computer program FairRent is available from county extension offices. It is designed to help evaluate both cash and crop share arrangements.

Developing a fair flexible cash lease arrangement

The wide swings in crop yields, prices, and rents over the past two decades have increased interest in alternatives to simple cash rent. However, many farm operators and landowners do not want to become involved in the complexities of a crop share arrangement. As a result, interest in flexible cash lease arrangements has increased.

Flexible cash lease arrangements can be set up on a **price only**, **yield only**, or **price and yield** adjustment basis. These arrangements also can be set up so that the landowner receives a portion of the rent in cash in the spring with the balance being a flexible rent amount received at final settlement time. Worksheet 1-3 can be used to develop such an agreement.

In considering or using flexible rent, keep in mind that:

- If yields tend to fluctuate in the area, do not use the "price only" arrangement.
- If a minimum rent is established, also set a maximum rent.
- In the lease agreement, be sure to indicate when and at what market(s) the crop selling price will be determined.

Worksheet 1-1. Determining a landowner's desired cash rent.

	Example	Actual	
Per acre value of crop acres	$900		1
Total tillable crop acres	140		2
Total value of cropland (1 x 2)	$126,000		3
Desired return on investment (6% - 8%)	$8,820		4
Real estate taxes	$1,500		5
Insurance (fire, wind, liability)	$450		6
Other cash costs (repairs, etc).	---		7
Management charge if any	---		8
Total desired cash return (4 + 5 + 6 + 7 + 8)	$10,770		9
Desired cash rent/acre (9 ÷ 2)	$77		10

Arriving at fair hay and pasture land rental rates

In many areas, not all of the land can or will be planted to row crops and small grains. Hay and pasture land often are valuable enterprises as well, and these do have a cash rental value in most areas.

Determining hayland rents: Landowners cash renting alfalfa hayland on a one-growing-season basis have some additional operating expenses that are not found on land typically rented for row crops and small grain production. These added expenses include the cost of alfalfa seed and possible liming of the soil. As a result, hayland normally rents for 115% to 125% of comparable productive land rented for row crops and small grain production. In order to charge this cash rent per acre, it is expected that there will be a decent stand and resultant yield.

Following is an example of how this rental charge could be calculated on a per bale basis:

Regular cash rent/acre for hayland is:

$80 X 120% = $96/acre rent

Divide cash rent by expected yield:

$$\frac{\$96/\text{acre}}{4\ \text{ton/acre}} = \$24/\text{ton}$$

Divide cash rent/ton by bales per ton:

$$\frac{\$24/\text{ton}}{50\ \text{bales/ton}} = 48\ \text{cents/bale}$$

If the hayland is rented for just one crop, the per bale charge should be higher (e.g. 55-60 cents per bale), since the renter can estimate the size and quality of the crop before deciding to rent.

Determining pasture charges: Pasture land cash rent usually is based on the land's ability to support a certain number of beef cows and/or dairy heifer replacements during a given pasture season. Typically, the landowner provides the pasture land, some extra fence posts, and wire to repair fences. The renter provides the livestock, livestock supervision, mineral and salt, and labor to repair fences when needed.

The cash rent income a landowner should receive on a parcel of pasture land depends on that pasture's ability to carry a certain number of livestock from spring through fall. Charging on a head per month basis usually prevents (a) overstocking the pasture and (b) pasturing the land too early in the spring and/or too late in the fall. Typical rental charges in southern Minnesota, for example, are:

- Beef cow with calf: $7 - $8/pair/month.
- Dairy heifer: $3 - $4/head/month.

Pasture rents in northern Minnesota run somewhat lower-around $4 - $6 per cow/calf per month.

Developing a fair crop share arrangement

Like cash rental rates, the type of crop share arrangement typically found in an area is determined largely by the productive value of the land. For example, in Minnesota at this writing, in areas where cash rents range from $20 to $40 per acre, the 1/3 to 2/3 share predominates. The 40/60 share is most common in $40 to $60 per acre cash rent land, while the 50/50 predominates in areas with rents above $60 per acre. Table 1-3 indicates the **typical** sharing of operating costs in the major share rent areas of the state of Minnesota.

Table 1-3. Typical sharing of costs, landowner's share[a]

	Type of share arrangement		
	1/3-2/3	2/5-3/5	½-½
	-- percent paid by landowner --		
Seed	0	0	50
Fertilizer	33	40	50
Chemicals	33	40	50
Harvest	0	0	variable
Drying - fuel & electricity	33	40	50
overhead costs	0	variable	variable
at elevator	33	40	50

[a]In leases on land that is more productive than average for each type of share arrangement, some of the indicated expenses are **not** shared by the landowner. For example, for very productive land in south-central Minnesota, the landowner may pay nothing for either seed or drying.

A fair crop share agreement is one in which the landowner and farm operator share the crop in approximately the same percentage as they contribute inputs of land, labor, machinery, seed and fertilizer. Therefore, landowners and farm operators should use Worksheet 1.4 to calculate a fair share arrangement based on major crops grown. Crop shares and production expenses like those noted in Table 1-2 would then be shared in the same percentages as the overhead contributions. In some cases, adjustments are made in the respective contribution of crop operating expenses so that all expenses are allocated in a more conventional sharing, such as 40/60; rather than some odd sharing such as 43/57.

Some other knotty issues that need to be addressed in developing a share arrangement include:

- Hauling the landlord's share of the crop.
- Custom fertilizer and pesticide application charges.
- Lime and liming.
- Legume seed charges.
- Government program measurement charges.

Arriving at reasonable crop facility rental rates

The value of a farm building varies with its usefulness and the overall demand for that type of building in an area. In heavy crop-oriented areas for example, buildings other than grain bins, machine sheds, and possibly the house, are of little rental value. In heavier livestock-oriented areas, dairy and hog buildings and feeding facilities may be in greater demand and may command a reasonable rental amount.

Normally, landowners would like to have building rent cover taxes, insurance, and normal repairs and upkeep. These items typically account for about 3% of the building's value. Beyond this, they would like to receive some compensation to cover depreciation and interest on their investment. But how much beyond the 3% amount remains a big question. A rule of thumb for yearly cash rent charges on useful buildings is as follows:

Old: 6% - 8% of original investment cost
New: 5% - 6% of original investment cost

Normally, the *renter* would pay utility costs, minor building repairs, and equipment maintenance costs. The *landowner* would pay real estate taxes, fire and wind insurance, major remodeling and building repair costs, and for replacement of barn cleaners, silo unloaders, and livestock equipment. *Both* parties should carry their own farm liability insurance.

Written lease requirements; basic elements; special provisions[1]

Traditionally, written farm leases have been the exception rather than the rule. One reason is the assumption that requiring a written lease makes it look like the parties do not trust each other. It is, however, highly desirable to put the terms of any rental agreement in writing. A written agreement:

- Encourages a detailed statement of the agreement, which ensures a better understanding by both parties.
- Serves as a reminder of the terms originally agreed upon.
- Provides a valuable guide for the heirs if either the tenant or the landowner dies.

Time-related classes of leases; when they must be in writing

There are two time-related classifications of leases: (1) tenancy from year-to-year, and (2) tenancy for years or specified term longer than one year.

Tenancy from year-to-year

The **tenancy from year-to-year** is a periodic tenancy that is very common in many states. The important characteristic of this tenancy is that it can last indefinitely. In other words, it is deemed to renew itself automatically unless adequate notice

1. Portions adapted from *Farm Lease*, AG-FS-2593, by Phillip L. Kunkel and Brian F. Kidwell, Minnesota Extension Services, University of Minnesota, Revised, 1989

to terminate the tenancy is given. Typically a year-to-year tenancy is created by an oral agreement. But a year-to-year tenancy can be, and in many cases is, embodied in a written lease. Such leases are terminated when one party gives the other notice of termination as required in the written agreement. Without a written agreement, a tenancy from year-to-year can be terminated under Minnesota law, for example, if three months notice in writing is given by one party to the other party. If, however, the tenant fails to pay the rent due under a lease, only 14 days notice in writing must be given by the landlord to the tenant.

Tenancy for years or specified term

The second type of tenancy is a **tenancy for years or specified term.** The most important characteristic of this tenancy is that it is a tenancy measured by a period of time. A tenancy for years lasts for a specified time agreed upon in the lease. Unless the lease provides otherwise, no notice is necessary to terminate such a tenancy. The tenant's right of possession automatically terminates at the end of the specified period.

Any lease for a period or term longer than one year is void unless the contract is in writing and signed by the parties involved. Such leases come under the Statute of Frauds provision of law, which generally states that any agreement for more than $500 in value, and for a period of more than one year, is void unless the agreement is in writing and executed by the parties. To come under the Statute of Frauds, a lease must be *wholly oral.* The writing required to remove a lease from the application of the Statute of Frauds does not have to be a detailed contract. A memorandum or note is sufficient if it has been signed by the parties involved.

There is an exception to the Statute of Frauds that has been recognized by most courts, however. Even though a lease is unenforceable because of the Statute of Frauds, it may be enforced if one party relies on the contract and makes **substantial performance**. Substantial performance on the part of a tenant must be a rental payment or other action that would indicate that a person reasonably believes that such a contract exists. Because each case is unique, the facts must be determined on a case by case basis. A second exception to the Statute of Frauds has been created by the courts in which one of the parties has misrepresented or otherwise taken advantage of the other party. **The Statute of Frauds cannot be used to accomplish a fraud**. See the discussion of contracts in Chapter 2 Part II.

Beginning date of lease; terminating a lease while a crop is growing

Although in many farm states agricultural tenancies begin on March 1, some states have no law that determines when an agricultural tenancy begins. If a *lease is terminated while a crop is still growing*, the crop belongs to the tenant. Under Minnesota law, for example, the landlord must choose within 30 days after the lease ends whether to harvest the crop or permit the tenant to harvest it. The landlord must then make proper settlement with the tenant for rents paid and value of inputs used. If the landlord permits the tenant to harvest the crop, the tenant must pay the landlord for the fair rental value of the land during the time after the lease ended and until the crop is harvested.

In either case the amount owed may be secured by a lien that is given priority over all other liens if a financing statement is filed within the required number of days. The date on which a *tenancy from year-to-year would normally terminate* is also important because the date of termination determines when the written notice has to be given to legally terminate the tenancy.

Basic elements of a written lease

A landowner and a farmer are free to choose the type of relationship that will govern their arrangement. The lease agreement between the parties is critical in determining what rights and duties exist between landlords and tenants. The following elements are necessary to create a landlord/tenant relationship:

- A valid contract (the contract may be oral provided that there has been partial performance or actual occupancy).
- Provision for payment for use of the land.
- The transfer of substantial rights to the tenant.
- Possession and control in the tenant.
- A reversionary interest in the landlord.

Special production practices and land use provisions

Unless a lease provides otherwise, it is presumed that a tenant will conduct farming operations according to the prevailing custom or usages of the community. They are not required to leave the land in the same condition it was in when they took possession, however. The tenant has the right to determine the cropping system and rotation to be applied on the leased property. He/she must not commit **waste**, however.

What constitutes **waste** must be determined on a case by case basis. In general, the tenant must not allow the real estate to be permanently or substantially damaged. For example, the tenant may not remove valuable topsoil from the premises. Most courts, however, have often held in favor of tenants who have used poor husbandry practices such as permitting land to grow up in weeds and to go uncultivated. As a result, it is in a landlord's best interest to include specific provisions in the lease that detail what is expected of the tenant as part of the normal course of husbandry. Such provisions might include:

- Land use provisions, e.g., cropping patterns and practices, so as to protect government program crop bases and conservation plans.
- Environmental aspects relating to the use and handling of chemicals, fertilizers, etc.
- Operation and maintenance of the farm.
- Arbitration procedures in case of disagreements.

Protecting the landlord's interest in the crop; payment of rent provisions

An important issue in times of financial distress involves the title to growing crops. It is clear that, in the case of a cash rent lease, the crop belongs to the tenant. In the case of a crop share lease, however, the answer is not so clear. Most states have held that title to the crop remains in the tenant until he/she harvests the crop and divides it with the landlord. Other courts, including Minnesota courts, have held that, in the case of a crop share lease, a landlord's interest in the crop attaches after the crop has been planted. As a result, the landlord may sell his/her share of the crop prior to harvest.

Many states protect the landlord by giving him/her an **automatic landlord's lien** on crops grown or growing, to ensure payment of rent. The lien attaches as soon as the crop begins to grow. But the state of Minnesota, for example, does not have such an automatic statutory landlord's lien. As a result, the only way a landlord in Minnesota can secure the payment of rent is to obtain a **security interest** for the rent in the crops either through a provision in the farm lease or by a separate security agreement. This security interest must be created under the rules of the Uniform Commercial Code (UCC).

The first requirement in creating a valid security interest under the UCC is that the security agreement must be in writing. Therefore, to protect his/her claim for the rent, a Minnesota landlord must have a written lease or security agreement. The security agreement must also contain a description of the land upon which the crops are to be grown. If the security agreement is embodied in the lease itself, this requirement generally presents no difficulty. If a separate security agreement is used, however, care must be taken to ensure that a proper legal description is included. Besides the security agreement, a Minnesota landlord should insist that the tenant sign a **financing statement** that will allow the landlord to perfect his/her security interest in the crop.

To further ensure that his/her security interest will be the first lien against the crops, a **landlord lien statement** should also be prepared and signed by both parties and filed with the County Recorder. To perfect this lien, it must be filed within 30 days after the crops become growing crops. This lien puts the landowner in first position relative to income from the crop and other creditors. To further protect their financial interests, landowners should require that the tenant provide a signed statement as to which *grain buyers* they will sell the grain to. The landowner must, in turn, inform the specified buyers that he/she has a security interest in that grain.

Note: Laws protecting the landlord's interest vary from state to state; check with an attorney on this issue.

Rental arrangement publications

Selected rental arrangement publications and lease forms are available from MidWest Plan Service and county extension offices. A list of available publications can be found at the end of this publication.

Developing a monitoring system for rented land can be useful in negotiating cash rents and are a necessity with crop share agreements.

Records for monitoring and adjusting land rental arrangements; for reporting purposes

Records for monitoring cash rented land

With cash rented land, the farm operator is not required to provide information to the landlord. But records kept on cash rented land can be useful in deciding whether to continue renting a given parcel and when negotiating a new lease with the landowner. To do this, records of crop yields, crop prices, direct costs and an allocation of overhead costs would be needed.

Records for monitoring crop share leases

With crop share arrangements, the farm operator must keep accurate records of crop yields and crop expenses that are shared by both the landowner and farm operator. They should agree beforehand how often the landowner should receive progress reports regarding the crop and expenses. A year-end financial report is needed for income tax reporting.

Reporting to/educating the landowner

Increasingly, landowners have little or no knowledge of, or experience with, a commercial farm business. Therefore, one of the most important tasks of a farm operator/renter is to keep the landowner informed. In this process, the education of the landowner should also be part of the agenda. A good record system aids this process of keeping a landowner informed, answering questions, and discussing goals or concerns.

Selecting and keeping a good farm operator; a good landowner

As in most business endeavors, the success of a lease agreement hinges on the people involved and their ability to work together. Following are some guidelines in selecting and keeping good farm operators and landowners.

Selecting and keeping a good farm operator

In selecting a good farm operator, the landowner should first define personal goals, desired role, and needs. Will the owner be involved or let the farm operator run the show? Are there special needs such as use of cropland, pesticides, pasture land, and/or buildings? Does the land need to be handled in a special way? Will the prospective operator at least maintain the productivity of the land?

When starting a search, keep a low profile. Visit local businessmen and lenders. Find out which farm operators are doing a good job and are reputable and financially sound. The ideal candidate sets priorities well, is organized, positive, goal-oriented, stable, mature, cooperative, and will care for the property. Desired business and management traits include being experienced and well trained; having a growth potential in management; and having the machinery and work force to get things done well and on time.

It is important to remember that the farmer operator who is willing to pay the "highest price" may not be the best manager and caretaker of the land, or even be able to make payments if financial difficulty results from paying excessive rent or other unwise choices.

When sizing up a candidate, first visit the farm operator's home farm to be sure that the machinery and the farmstead are in order. This also will provide a chance to discuss farming practices and cropping programs being followed. Also, determine whether the potential farm operator can handle additional land by observing the amount of land he/she is presently operating and the timeliness of operation. Ask other landowners about the farming ability and integrity of the farm operator, and whether he/she is reasonable to work with. Also, check the potential farm operator's financial status. If there is any question about his/her honesty, cross him/her off the list.

Once a good farm operator is selected, how does one keep him/her? Communication is a must. Review lease arrangements at least once a year. If there are any concerns about how the property is managed, bring them up for open discussion. Compliment the farm operator for a job well done. Be flexible and reasonable in demands and rent asked.

Selecting a good landowner; hanging onto the rented land

When selecting a landowner, a farm operator needs to evaluate the landowner and determine if the farm fits plans and needs. For example, does the size and productivity of the farm meet the operators needs? Does the location of the farm mesh with other parcels? Do the farm buildings complement the ones on other farms?

As for sizing up a potential landowner, ask questions that will help determine if the owner:

- Is reasonable and easy to get along with.
- Is easy to communicate with and will discuss things openly.
- Understands farming, but will still let a farm operator operate.
- Is honest, stable, and consistent.
- Is open minded regarding new practices and possible farm improvements.
- Is able to respect one's privacy and the fact that a farm operator will control the property for the term of the lease.

As far as being able to retain control of a farm, three key things help:

1. **Communicate.** Keep the landowner informed. Discuss big issues or changes and get them built into the lease or recorded as a separate agreement. Develop a crop plan that both parties can live with. Keep each other informed about emerging or existing problems, for example, delays in planting, or problems with disease or insects.

2. **Teach the landowner**. A landowner who is a nonfarm heir or a nonfarm investor may not know much about farming. Keep the owner informed as to the practices that are followed. Also, explain farm costs, crop reports, and markets.

3. **Keep the farm in shape**. Little extras pay big dividends. A neat farmstead and mowed roadsides are examples of investments in good will.

Worksheet 1-2. How much cash rent can a farm operator afford to pay?

Projected gross income/acre-each crop	Crop					
(List crops)	______	______	______	______	Set-aside	
Expected yield	______	______	______	______	XXX	1
Expected price (cash or loan)	$______	$______	$______	$______	XXX	2
Crop income (1 x 2)	______	______	______	______	XXX	3
Other income (government, hay, straw, other)	______	______	______	______	XXX	4
Projected income/acre (3 + 4)	**$______**	**$______**	**$______**	**$______**	**XXX**	5
Projected direct expenses/acre-each crop						
Seed	$______	$______	$______	$______	$______	
Fertilizer	______	______	______	______	______	
Chemicals	______	______	______	______	______	
Crop insurance	______	______	______	______	______	
Custom hire	______	______	______	______	______	
Fuel, oil	______	______	______	______	______	
Drying, utilities	______	______	______	______	______	
Repairs	______	______	______	______	______	
Seasonal labor	______	______	______	______	______	
Operating interest	______	______	______	______	______	
Projected direct expenses/acre-each crop	**$______**	**$______**	**$______**	**$______**	**$______**	6
Overhead charges/acre-each crop						
Operator/regular labor & management	$______	$______	$______	$______	$______	7
Machine ownership	______	______	______	______	______	8
Other overhead	______	______	______	______	______	9
Total overhead costs/acre (7 + 8 + 9)	**$______**	**$______**	**$______**	**$______**	**$______**	10
Total listed costs/acre (6 + 10)	$______	$______	$______	$______	$______	11
Return over listed costs/acre (5 - 11)	**$______**	**$______**	**$______**	**$______**	**$______**	12
Acres of each crop	______	______	______	______	______	13

Determining the average affordable cash rent/acre		
Average gross income/acre [(5 X 13) ÷ total Acres]	**$______**	14[a]
Average total listed costs/acre [(11 x 13) ÷ total acres]	**$______**	15[a]
Average machine ownership/acre [(8 x 13) ÷ total acres]	**$______**	16[a]
Rent after covering total listed costs (14 - 15)	**$______**	17
Rent after covering all but machine costs (16 + 17)	**$______**	18
Rent if gross income was 10% lower [14 - (14 x .10) - 15]	**$______**	19

[a]Multiply acreage of each crop (line 13) by the income or expense line indicated and divide total by total acres involved.

Worksheet 1-3. Flexible cash rent approaches.

Adjusting for price only approach:

Formula:

Crop	Base cash rent	x	Actual price ÷ Expected price $2.05	=	Adjusted cash rent
Example: Corn	$80	x	$2.15	=	$76.25
________	________	x	________	=	________
________	________	x	________	=	________

Adjusting for yield only approach:

Alternative 1. Yield adjustment approach.

Formula:

Crop	Base cash rent	x	Actual yield ÷ Expected yield 140	=	Adjusted cash rent
Example: Corn	$80	x	125	=	$89.60
________	________	x	________	=	________
________	________	x	________	=	________

Alternative 2. Fixed and flexible rent combination.

Example: Cash rent $80/acre

Crop	Spring payment	After harvest payment
Corn	$40	$0.35/bushel/acre
Beans	$40	$1.00/bushel/acre
________	________	________
________	________	________

Adjusting for price and yield:

Alternative 1. Price and yield adjustment approach.

Formula:

Crop	Base cash rent	x	Actual price ÷ exp. price $2.05	x	Actual yield ÷ exp. yield 140	=	Adjusted cash rent
Example: Corn	$80	x	$2.15	x	125	=	$85.40
________	________	x	________	x	________	=	________
________	________	x	________	x	________	=	________

Alternative 2. Fixed % of crop approach.

Fixed percent of crop - assumes landowner shares in government program payments, if any:

- Example: **Southern Minnesota**, 30-35% of crop delivered to landowner.
- Example: **Northern Minnesota**, 25-28% of crop delivered to landowner.

Alternative 3. Fixed and flexible rent combination approach.

Example: Cash Rent = $80

Crop	Spring payment	After harvest payment
Example: corn	$40	15% of Crop Delivered to ________.
________	________	________
________	________	________

Worksheet 1-4. Developing a fair crop share arrangement.

Crop: Corn	Yield = 120 bu		Yield = ____ bu	
	Example share		**Actual situation**	
	Landowner	**Tenant**	**Landowner**	**Tenant**
Desired crop share arrangement [a]				
Non-shared contributions	50%	50%		
Land - cash rent equivalent	$80	---		
Machinery (replacement and repair)	---	$50		
Gas, oil and grease	---	10		
Labor and management (plant and harvest)	0	20		
Other ____________	0	0		
Total Non-shared contributions	**$80**	**$80**		
Percent non-shared contribution provided [a]	**50%**	**50%**		
Shared expenses - in the desired [a] percentage stated above:				
Seed	$12	$12		
Fertilizer (starter, broadcast, nitrogen) [b]	$16	$16		
Chemicals [b]	$7.50	$7.50		
Hail insurance	$2.75	$2.75		
Insecticide	$2.50	$2.50		
Interest, operating loan	$2.80	$2.80		
Drying	$9.00	$9.00		
Trucking *(operator hauls one time; costs are in fixed contribution)*				
Hired labor *(farm operator provides all labor)*				
Storage *(each party stores their own)*				
Total shared expenses	**$52.55**	**$52.55**		
Total shared and non-shared expenses	**$132.55**	**$132.55**		

[a] If the percentage of non-share contributions provided by each party differs from the desired shared percentage, adjustments can be made in shared expenses to bring the total shared and non-shared expenses in line with the desired share. In the example, no adjustment is needed.

[b] If fertilizer or chemicals are applied by a commercial operator, an agreement needs to be reached as to who will pay the application charges. In many cases, the landowner pays a share of this cost.

Analyzing/financing farm real estate purchases

2

- **Analysis: Worth of land compared to its apparent market value**
- **Analysis: How would purchase affect the short- and long- term financial situation?**
- **Analysis: Check environmental, title, and other legal aspects?**
- **Analysis: How much to bid? Bargaining strategy?**
- **Financing the purchase: The mortgage route**
- **Financing the purchase: Contract for deed**

Purchases of farm real estate are often the most important investment decisions a farm operator will make. Typically, such purchases are made only a few select times in one's farming career. But, because of the large size of investment often involved, such purchases can have a marked effect on the profitability and financial soundness of a business.

The first four segments of this chapter address the broad question: Will this proposed purchase be a good, long-term investment? This involves analyzing the purchase in these terms:

- What is the worth of the farm/parcel to one's business, as well as its apparent market value?
- How would the purchase affect one's short- and long-term financial situation?
- What are environmental, title, and other legal aspects?
- What resultant bargaining strategy should be adopted, including how much to bid?

The last two segments of the chapter focus on financing the purchase, using the mortgage and contract for deed instruments.

Analysis: Worth of land compared to its apparent market value

This segment first considers some factors that will impact the future value of a property (either a parcel or entire farm) and then presents two broad analytical approaches that might be used to determine what the purchase might be worth to one's business. Then a procedure for determining the apparent market value of the property using comparable sales is presented.

Factors affecting land values; likely future course

When a farm manager is faced with a decision to buy farm real estate, one of the key questions to be answered is what is likely to happen to land values over time? Since farm real estate is usually viewed as a long-term investment, what happens to the underlying value of the property has a marked effect on what one can afford to bid for a given property.

Following is a discussion of the major underlying factors affecting land values and then an illustration of their impact on the future market value of a property.

Factors affecting land values

Factors affecting farmland values can be grouped as physical, locational, economic, and aesthetic. Economic factors tend to set the tone of the market, i.e., land prices are rising, stable or falling. The other factors determine the relative value of a given property compared to another property.

Physical factors.

The major physical factors affecting farm values are topography, soils, buildings and improvements. Topography can be a major factor affecting land use. It also affects the size of machinery that can be used, soil erosion hazards, soil drainage, and water holding capacity. The potential farm buyer should obtain a description of the soils on the farm in question from the local county Natural Resource Conservation Service (NRCS) District office or the County Extension Service. The crop production rating of the soils should then be checked with the NRCS and Extension Service. A University of Minnesota Experiment Station report, "Crop Equivalent Rating Guide for Soils of Minnesota" (AD-MR-2199), provides this information on a state-wide basis. Most states have similar information readily available from like sources.

Existing building and improvements will either add to or detract from the value of a parcel/farm, depending on the kind and condition of buildings, and type of farming in the area.

Locational and aesthetic factors.

Climate limits the kinds and yields of crops that can be grown in any particular area. For example, in Minnesota, the average annual rainfall varies from a low of about 19" in the northwestern part to a high of about 32" in the southeast. The average growing season also varies from about 100 days in northern Minnesota to 160 days in southeastern Minnesota. In addition, off-season frost is more frequent in the northern part of the state. The low rainfall patterns of western Minnesota increase the chances for drought and decrease potential crop yields in comparison with eastern Minnesota. Contact the local Extension office for similar data.

Local community factors can also affect land values. Aggressive buyers in certain communities may bid up land prices. Other communities may have special market outlets and/or high return contract crops that tend to push up land prices. Prices for land near urban areas and large cities will be influenced by the demand from rural residents, part-time farmers, and city investors. In contrast, farms farther from large towns and difficult to reach will command lower prices.

Since **aesthetic values** vary greatly with individuals, it is difficult to assign an objective value to them. Aesthetic factors include visual appeal of buildings, the view from the house, etc., which will either add to or detract from farm value. Potential owners value rivers, lakes, or wooded areas differently depending on personal preferences and plans for the land.

Economic and psychological factors.

Three measurable economic factors have a major influence on the general tone of any land market: the land's earning capacity, inflation expectations, and interest rates. As in any market, a fourth, but less measurable factor—the psychology of the market—must also be considered.

The single most important economic factor is the **earning capacity** of a given piece of land. Earnings vary around a state. For example, an acre of southern Minnesota crop land will earn a much higher return than an acre of wooded pasture in northeastern Minnesota. (These productivity differences are caused by physical and locational factors, which were discussed above.)

Earning capacity of a given piece of land also varies over time. If the earning capacity remained the same through time, the price of land would remain fairly stable. Thus, if an acre yields a continuous net return of $60 every year and the desired rate of return was 10%, the productive value of that acre would remain near $600 ($60 ÷ 10%).

But the earning capacity of land has not remained constant. Improved technology, management, and markets resulted in a fairly consistent rate of increase in the real earning power of land between 1950 and 1980. One study estimated that the real rate of return to farm assets during the 1950-1975 period increased at an annual rate of 4%.[1] If such an annual increase were built into one's expectations, a manager could afford to pay considerably more than could be paid under more stable earnings situations. For example, on land that currently earns $60 per acre, one could subtract the 4% annual earnings increase expected from a desired (10%) rate of return to get an adjusted annual return rate of 6%. Using this 6% rate, a $60 annual income would capitalize out at $1,000 per acre instead of the $600 suggested by the 10% rate.

Expectations regarding **inflation** affect land prices in two ways. The first benefit comes from increased earning capacity and the resultant opportunity to pay a mortgage or contract for deed with cheaper dollars—an **earnings dividend** from inflation. The second benefit is a **growth dividend**: the fact that real property usually holds its value during periods of inflation, protecting dollars from further depreciation. The distinction between earnings and growth dividends resulting from inflation is important in that *earnings dividends will pay debts and buy groceries, while growth dividends will only increase net worth until the property is sold.*

Interest rates generally have been set equal to a fixed or real rate of return plus adjustment for the going rate of inflation. If the normal real rate of return was 4% and inflation was 6%, the market rate of interest would be about 10%. But in recent years the relationship has become distorted. In the late 1970s the market rate of interest failed to keep pace with inflation. This caused the real rate of interest to become negative. For example, a 10% market interest rate and a 12% inflation rate meant a real rate of interest of –2%. Such a situation caused many farm buyers to become very aggressive, since they were in effect "being paid to borrow money." The rapid advance of land prices also permitted them to highly leverage their financial position. During the mid-1980s the relationship reversed, causing very high real rates of interest and many financial problems. For example, a 13% market interest rate during a period of reduced inflation of say 5% would provide a real interest rate of 8%—a very high rate by historical standards.

In the recent volatile land market, the **psychology of the market** also played an important economic role. During the late 1970s sellers and buyers both expected land price increases to continue at a high rate. This caused land prices to rise rapidly as buyers became fearful that they had waited too long to get into the market. As land prices began to fall, a standoff developed and very little land changed hands as sellers hoped that prices would recover and buyers hoped they would go even lower. As the slide continued, sellers became fearful or were forced to sell, while buyers continued to "wait for the bottom," thus pushing land prices down more than they otherwise would go. The "bottom" was reached in 1987. Land prices rebounded faster than expected, reflecting at least in part that the market had overreacted on the downside. Those with large cash holdings were able to buy the farm they had always wanted, and at a bargain price.

Projecting the likely long-term future course of land values

The long-term course of land values depends largely on what happens to farm earnings, interest rates and inflation. Table 2-1 illustrates the marked effect these factors have had on land values, as well as their likely future impact under various assumptions.

Following are some observations that may help project the likely future course of land values in an area. In the long run, **farm earnings** will likely improve but also be more variable. Technology gains would suggest a modest increase in land values over time, though concerns with the environment, food and worker safety may limit its use and impact. Uncertainties relative to export markets and government programs would suggest fluctuations in prices and earnings, thus the need to use conservative estimates of farm earnings when making projections. **Interest rates** will likely continue to fluctuate as will **inflation**.

Thus, it is expected that land values will tend to increase over time, though there may be periods of stagnation and even modest decline. Of course, if a period of double digit inflation occurs, all bets are off. Also, expect that differences in

1. Emanuel Melichar, *Capital Gains Versus Current Income in the Farming Sector*, American Journal of Farm Economics, Volume 61, Number 5, December 1979.

Table 2-1. Combined effect of selected economic factors on land values, an illustration.

	Past happenings		The future	
	1972	1981	Low inflation	Moderate inflation
Market interest rate	9%	12%	11%	12%
Less annual increase in earnings				
from technology	2	3	2	2
from inflation	1	6	3	6
Equals capitalization rate	**6%**	**3%**	**6%**	**4%**
Expected earnings (current $)	$40	$100	$80	$100
Divided by cap rate	0.06	0.03	0.06	0.04
Resultant land value	**$665**	**$3,330**	**$1,330**	**$2,500**

values between high and low quality land will likely widen over time. Technology and the current emphasis on the environment and conservation will be important causal factors.

John Scott[2], from the University of Illinois, offers some additional factors to consider. Though his land price outlook is similar to that of this author's, he notes that: "The physical relationships of producing ever-higher yields are always in doubt. It is a biological process that, logically, does have a limit; but with new technological developments such as gene splicing and hormone controls, we do not see yields leveling off or declining in the near future. Past trends indicate that it would be foolhardy, at least in the short run, to bet against the ingenuity of man to develop new technologies to increase output.

"The demand side is also important. Production of food is rising faster in the less-developed countries than population. Domestic demand, except for some shifts among products, such as, from red meats to poultry and fish, will not likely grow faster than population. Demand factors, along with increasing production, make it very unlikely that land values will increase more than the general rate of inflation, as they did from 1972 through 1980. *It is more likely that land prices will increase, but at average rates somewhat less than the general rate of inflation.* This will be particularly true after the current price rebound has run its course.

2. John T. Scott Jr., *Trends In Farm Real Estate*, North Central Regional Extension Publication No. 51, 1990, page 27.

"The elasticity of food production is said to be determined by the elasticity of the stomach. Judging by the number of diet ads and exhortations about what and how much to eat, the stomach's limits of elasticity have been reached in this country."

What is this land worth to the business? Two broad approaches

What one can afford to bid for a farm or parcel depends on the situation and expectations regarding the future. Consider these factors:

- Expected annual net returns to land.
- Expected capital gains (land appreciation-see above discussion).
- Desired rate of return on investment.
- Financing terms and tax position.
- Length of planning horizon and eventual disposition of the property.
- Other factors: desire to control land, proximity to the home farm, etc.

There are two broad approaches that could be used for determining what the farm or parcel is worth to the business: the quick and dirty approach, and the one involving a more detailed analysis.

The "quick and dirty" approach: A couple of options

The simplest "quick and dirty" approach is to divide the expected net cash rent (cash rent minus real estate taxes) by an appropriate interest rate or capitalization factor. See Worksheet 2-1.

Worksheet 2-1. "Quick and dirty" approaches to determine land worth to the business.

- **Cash rent approach.**

For example: $\frac{\text{Expected cash rent - Real estate taxes}}{\text{Interest rate/Capitalization factor}} = \$90 - \$15 = \frac{\$75 \text{ net cash rent}}{.05 \text{ cap rate}} = \$1{,}500$ estimated value

- **Adjusted cash rent approach.**

A slightly more complex "quick and dirty" approach allows adjustments for technology and inflationary impacts, as well as for location, buildings, etc.

	Example	Specific situation	
Expected net return per crop acre? (Cash rent/crop acre less taxes, insurance, maintenance)	$ 80	$	1
Nominal interest rate (Rate expected during next decade)	12%	%	2
Less annual % increase in earnings			
From technology 2%			
From inflation 4%	6%	%	3
Capitalization rate (line 2 - line 3)	6%	%	4
Capitalization rate expressed as decimal (e.g. 5% = 0.05)	0.06		5
Capitalized value of net rent/acre (line 1 ÷ line 5)	$ 1,330	$	6
Total value of crop acres (line 6 x 140 crop acres)	$ 186,200	$	7
Adjustments for: location, buildings, house	$ 40,000	$	8
pasture, woodland	$ 0	$	
Estimated total value of farm/parcel (line 7 + line 8)	**$ 226,200**	$	9

"Detailed" Earnings Approach—A Couple of Options

The second broad analysis approach involves a more detailed earnings analysis. Worksheet 2-2 is designed to assess in more detail how much the property is worth. This involves projecting the expected gross income and direct expenses associated with each of the crops grown. It also involves projecting overhead costs for labor, machinery, and real estate taxes, insurance, and management. With this information, one can then project the residual return for various crops and expense situations. Using a selected capitalization rate, one can then determine the capitalized value of the property—its worth to the business.

The farmer manager who is at a crossroads, or in the process of developing a revised business plan, should also do a whole farm budget analysis, as described in Chapter 3 Part I of this series. This would involve both a comparison of alternative investments as well as the impact of such a purchase on the cash flow and solvency position of the business.

Determining apparent market value using the comparable sales approach

Next check how the asking price for the property compares with sales of comparable properties in the area. This sales or market data approach entails comparing the sale property (subject farm) with comparable farms recently sold in the area. It is based on the principle that market forces are the best indicators of a reasonable asking price. This would be a good time to involve a professional farm real estate appraiser in this process.

This approach involves: 1) selecting comparable recent sales in the area, 2) verifying that each is a bona fide farm sale, and then 3) making adjustments in the expected price for differences between the subject farm and comparable sales. Since no two farm properties are exactly alike, select farms that are as similar as possible to the subject farm in terms of location, size, soil, productive capacity, and buildings and improvements. If the farm being appraised is a dairy farm, comparable sales considered should be dairy farms. Always use the most recent sales for comparison.

To determine whether the comparable sales actually represent market value, determine the motivating factors of both seller and buyer. The American Society of Farm Managers and Rural Appraisers recommends that appraisers be guided by this definition when checking comparable sales: **"Market value is the highest price estimated in terms of money which the property would bring if exposed for sale in the open market; with reasonable time allowed in which to find a purchaser, buying with knowledge of all of the uses and purposes to which it is adapted, and for which it is capable of being used."**[3]

Study comparable sales carefully, and adjust prices for differences between them and the subject farm. Important factors to consider when adjusting sales prices include time of sale, size of farm, productivity, buildings and improvements, and location. Worksheet 2-3 at the end of this chapter provides a format for adding up the pluses and minuses, reflecting differences in the per-acre value between the subject property and the comparable sale farms for each of these five factors.

Conclusion: Is the asking price reasonable?

To make a decision as to whether the asking price is reasonable, answer questions such as:

- How does the asking price compare with the projected worth of the property to the business?
- How does the asking price compare with the apparent market value of the property as determined through the use of comparable sales (Worksheet 2-3)? Is the asking price higher or lower than its apparent market value?
- Conclusion: Is the asking price reasonable? If not, what would be a reasonable bid price?

Analysis: How would purchase affect the short- and long- term financial situation?

If the proposed purchase appears to be priced right as a long-term investment, the next question is: How would the purchase affect the short- and long-term financial situation? Here, its likely impact upon the financial soundness of one's business is first explored. Then the question, "Does investing in more real estate fit one's personal/financial situation?" is addressed.

What effect would the purchase have on the financial soundness of one's business?

The question here is, "What would such a purchase do to the financial soundness of one's business?" Explore three aspects of this question: (1) liquidity, (2) solvency, and (3) risk management considerations/options.

3. *Professional Rural Appraisal Manual.* American Society of Farm Managers and Rural Appraisers, Inc. Fourth Edition, January 1975. page 21.

Liquidity: Can debt repayment demands be met?

Land purchases often put substantial stress on the cash flow position of a business since cash earnings from land are often less than debt repayment demands. Worksheet 2-4 provides a "quick and dirty" approach to determining if the proposed purchase will cash flow.

This involves projecting the expected net cash earnings (line 3) from this parcel and then calculating the amount of debt that can be serviced (line 5). Then subtract from the asking price for the parcel (line 6) the debt that can be serviced (line 5), to determine the down payment needed (line 7). From this amount subtract the down payment funds available (line 8). If there is a short fall (at line 9), this amount needs to be converted to an annual cash flow deficit (line 10). Then determine whether there is cash available from other sources to subsidize the purchase (line 11).

If the surplus is not sufficient to meet cash flow demands, first determine an affordable price to pay for the property in order for the purchase to cash flow (line 13). The other avenue to explore is what change in financing terms (years to repay and interest rate) would be necessary to make it possible to meet debt repayment demands (line 17). Note also that the above quick and dirty analysis does not consider the income tax effects of the purchase.

If there appears to be a potential cash flow problem, do a more detailed cash flow analysis. This involves making a total farm cash flow projection over the next three to five years. (See discussion of cash flow planning in Chapter 4 Part I). This is particularly true if a considerable subsidy from other sources is needed to make the cash flow work. Also, if one is planning to borrow funds to cover part of the down payment, determine what this will do to the overall cash flow situation as well.

Conclusion. Is it possible to meet the debt repayment demands? If it is a close call, check cash flow under two or more scenarios. An often overlooked item is the cost of "fixing up the place," once it has been purchased—whether it be the buildings, drainage, or other improvements.

Solvency: What's likely to happen to the balance sheet?

Next, project the impact of the purchase on the balance sheet. What would the purchase do to various financial ratios and resultant net worth? The most common snags include: (1) driving up short-term debt/asset ratios, (2) a rise in long-term debt/asset ratios, and (3) a potentially sharp drop in one's borrowing capacity.

Because of the importance of this leverage/liquidity situation relative to the future of a business, put this purchase to the acid test. A simple test would be to reduce land asset values by 15%. If the debt/asset ratios still look reasonable, it would indicate that one could stand an erosion in land values. But, if one is 70% in debt, a 15% drop in asset values would cut an already modest equity in half. Younger farmers, who attempt to get into the land market too soon, often experience such a happening. This results either because of a reduction in asset values or a tightening of current and intermediate debt-to-asset ratios, as those areas are called upon to subsidize land payments.

Risk management considerations/ options

As the above discussion indicates, a land purchase can put considerable pressure on the financial soundness of a business—at least in the short-run. Therefore, explore ways of moderating associated risks. Following is a list of some options:

- Check out the deal with one's short- and intermediate-term lender(s). Make sure there will be adequate funds to operate the business once the farm or parcel is purchased.
- Consider use of crop insurance on major crops grown.
- Be ready to take a more defensive hedging position by forward pricing grains, etc.
- Find sellers/lenders who will go with fixed-rate financing and/or a non-recourse contract.
- Consider adding more life, major medical, and disability income insurance to protect oneself and one's family. This should include so-called credit life insurance to cover the debt if something should happen to the manager/owner.

Does investing in more real estate fit one's personal/financial situation?

It is also important to consider how such an investment would fit with one's present personal and financial situation. To aid this process, some background on alternative investments is provided. Then several factors relating to one's personal and financial situation are discussed. These need careful consideration in determining whether investing in more farm real estate is the prudent thing to do.

Some background on alternative investments

Investments can be divided into four major groups ranging from conservative to more aggressive:

1. Money Market Funds.
2. Income Investments (bonds, deferred annuities).
3. Growth and Income (stocks and bonds).
4. Growth Investments (stocks).

The typical relationship is that higher average returns are achieved only by accepting more risk, Table 2-2. However, historically, farm real estate has displayed higher rates of return with less risk than most investments. Technology and government support programs have played a role in this.

"Don't carry all your eggs in one basket" is sage advice. But, two questions remain: (1) how many baskets? and (2) how many eggs per basket? The correlations noted in Table 2-2 suggest that treasury bonds and corporate debt returns tend to move in the opposite direction to farm real estate, while stocks are neutral, and residential real estate returns tend to move in the same direction as farm real estate. The relatively strong correlation with the consumer price index indicates farm real estate values respond positively to inflation, thus, farm real estate is often viewed as a hedge against inflation.

One's Situation and this Pending Purchase?

One's particular investment strategy should depend on four things:

1. Risk profile.
2. Time frame.
3. Present investment portfolio.
4. One's recent financial track record.

Risk Profile. Conservative, moderate or aggressive? More pointedly, what is the manager's and the family's attitude toward added risk and debt; the ability to withstand adversity? If one decides to go ahead with a purchase, make sure all affected parties are also committed to it, so it doesn't become an "I told you so" deal.

Time Frame. Two basic guidelines seem appropriate:

- The longer the time to retirement, the more aggressive one may want to be in investing for long-term growth. There is time to ride out the ups and downs of the market.

- The closer to retirement, the more conservative and income-oriented one should be. If one loses money, there will be fewer assets for future use and less time to rebuild equity.

Present Investment Portfolio. Would this purchase mean adding more land to an already heavily land-dominated balance sheet? It is likely that future government policies toward agriculture will be less gratuitous than in the past. Also, since much of U.S. agriculture depends on world markets, it is likely that farm prices will be more volatile over time. This suggests that a more diversified investment portfolio will fare better.

Recent Financial Track Record. Have business earnings been increasing, decreasing, variable or stable in recent years? What has been happening to the balance sheet? Refer to the discussion in Chapter 2 Part I, and review the trends relating to one's own business financial performance.

Conclusion: Does the proposed investment make sense financially?

- After considering the impact of the investment on liquidity, solvency and risk, does the purchase make sense? Yes _____ No _____. If no or maybe, what are the main concerns?

- How does such a purchase fit with one's present personal and financial situation?

Table 2-2. Average rates of return and risk for various investments; correlation with farm real estate, 1947-1984.[a]

Asset	Average return	Average risk[b]	Correlation with farm real estate[c]
	percent per year		
Treasury Bonds	3.56	8.58	-0.34
Long-Term Corporate Debt	3.90	9.75	-0.30
Residential Real Estate	7.73	3.80	+0.47
Farm Real Estate	10.63	7.90	—
Corporate Stock	12.49	17.17	+0.04
Consumer Price Index	4.58	3.87	+0.36

[a] Source: *Farmland As An Investment Alternative*, by Sherrick, Foster and Irwin, Ohio's Challenge, Summer 1990, Vol. 3, Issue 2, Tables 1 and 2.
[b] Average risk = The average yearly percentage variability in returns from that type of investment.
[c] Correlation With Farm R.E. = A number between 0 and +1 indicates that the assets' returns tend to move in the same direction; a 0 to -1 indicates that the assets' returns move in opposite direction.

Analysis: Check environmental, title, and other legal aspects

Like the whole farm business enterprise, buying farm real estate requires careful attention to numerous legal issues. This is particularly true if one buys land for cash or on a contract for deed. Commercial lenders will likely check into most of these issues, but only for their benefit. Consequently, it's imperative that the buyer perform his/her own "due diligence" analysis, including the following issues.

Environmental issues

The following represents a list of some environmental issues to be explored before buying a property.

- Is the present water supply contaminated?
- Are abandoned wells in compliance? If not, who will pay to bring them into compliance?
- Check for underground fuel tanks and their condition.
- Check for old dump sites that may be contaminated.
- In some areas, sink holes and the location of livestock units near residential areas can be problems.
- Check conservation plans for the farm. Has the seller been in compliance? How do the plans affect the farming system the manager intends for the property?
- If Conservation Reserve (CRP) land is involved, has the CFSA (Consolidated Farm Service Agency) been notified of the sale? Failure to do so may void the CRP Contract.
- Check for the seller's prior compliance and any past records of violation of state and federal laws or regulations.

Check with an attorney and/or appraiser regarding these and other environmental aspects, and how best to protect oneself from possible oversight.

Title and other legal aspects

There are several **title-related aspects** that should be checked by an attorney before buying property. These include such items as:

- Are there any problems of getting a clear title to the property? Will the deed be warranty or quit claim? Elements and consequences of each include:

A **warranty deed** warrants that the grantor (seller) purports to convey property free and clear of all encumbrances, except those noted in the deed. The warranty deed creates a liability for the grantor (seller) if the title transferred is defective. The **quit claim deed**, on the other hand, merely conveys whatever interests the grantor (seller) has or may have. Consequently, such a deed does not give rise to damages against the seller in the event the title is defective.

- Are there any security interests still in effect that involve the property and the seller? These include mortgages, other liens, such as tax liens, medical assistance liens, or bankruptcy.

- Should the property be held in sole ownership, joint tenancy, or tenants in common? Check this with a tax consultant and attorney as there may be tax and estate planning issues involved.

There are other legal aspects to be checked, such as:

- Any existing or potential leases or easements affecting the property?

- Any zoning ordinances or other land use restrictions in effect that would affect the use of the property, the sale of lots, etc.?

- Any mineral or water rights involved?

- Check actual boundaries of the property compared with legally described boundaries.

Analysis: How much to bid? Bargaining strategy?

If the preceding analyses gave positive responses to the possible purchase of the property, the next step is to develop a bargaining strategy.

An important component of this involves deciding how much to bid for the property. Remember, the asking price for a farm does not constitute the actual market price—the farm hasn't been sold yet! Since the first offer is seldom the highest price the buyer would pay nor the lowest offer the seller would accept, both parties should be prepared to bargain to determine the "market price".

In formulating a bargaining strategy, consider: (1) how urgently a particular tract of land is needed, (2) the pressure on the seller to generate cash, and (3) the alternatives open to both parties.

Financing the purchase: The mortgage route[4]

The preceding segments discuss the process of determining whether a given real estate purchase will cash flow and its potential impact upon the solvency of a business. This and the next segment describe and discuss the various ways real estate purchases can be financed, with particular emphasis placed on the legal ramifications when using these various methods.

Of course, the simplest method of financing farm real estate is to pay cash for it. In that case, the buyer pays the entire purchase price in exchange for the deed to the real estate. Generally, this financing approach requires an established farm manager who is in an excellent financial position, with large cash reserves or assets that can be converted readily to cash. Most farm real estate buyers however, do not have sufficient cash to pay the total purchase price. They must resort to

4. Adapted from *Mortgages and Contracts for Deed* (AG-FS-2591) and AG-FS-2594, *Mortgage Foreclosures*, by Phillip L. Kunkel and Brian F. Kidwell, Minnesota Extension Service, University of Minnesota, Revised 1989.

borrowing from a lender, which usually results in the use of a **mortgage lien**, or from the seller of the property under a **contract for deed**.

About half of present-day farm real estate purchases are financed by a lender, which usually involves a mortgage lien. Thus, it is important to understand the legal nature of the mortgage instrument, possible causes of default of the loan, and the remedies open to a lender.

The mortgage instrument—a brief description

In a mortgage transaction, the buyer of the land (also known as the mortgagor) receives a deed to the real estate, but finances a portion of the purchase price by giving a lender (also known as the mortgagee) a promissory note and securing the note with a lien or mortgage on the real estate. If the buyer does not deal with a third party lender but rather, the seller agrees to finance a portion of the sales price by means of a mortgage, the buyer makes a down payment on the land and executes a mortgage with the seller for the balance. In such a case, this mortgage is known as a **purchase money mortgage**. If the situation applies, the seller may consider holding a mortgage as an alternative to placing the cash proceeds in a savings account or other cash accounts. *The capital gain on the sale of the real property financed by such a mortgage would be 100% taxable at the time of the sale.*

A real estate mortgage is a conveyance intended as a security for the repayment of the loan outstanding. Under Minnesota law, for example, even though a mortgage is a conveyance, legal title to the mortgaged property is not transferred to the lender. Minnesota is classified as one of the so-called **lien theory states**. In lien theory states, the lender has no right to possess the property, but merely has the power to sell the property in connection with a foreclosure.

When the mortgage debt is paid, the mortgage is discharged and the lender has no further interest in the real estate. When paid, the borrower is entitled to a **satisfaction** of the mortgage. This satisfaction must be recorded with the county recorder so as to extinguish the mortgage in the county records. Until this is done, the recorded mortgage will remain as a cloud on the title.

Issues can arise in the case of agricultural real estate with respect to whether a mortgage covers personal property that has become affixed to the real estate. Whether such personal property (such as storage bins, silos, milking equipment, or slurry-store systems) have become so attached to the real estate as to become part of the real estate, and thus non-removable, is a question that must be determined by a court based on the facts and circumstances of each case. To avoid such issues, the parties to a real estate mortgage should specifically describe in the mortgage whether certain items of personal property will become part of the real estate, subject to the mortgage.

Closely related to the issue of fixtures is the question of whether a mortgage covers crops growing on the land that is subject to a real estate mortgage. To obtain a lien on crops, a lender must comply with the provisions of the Uniform Commercial Code with respect to such claims. Unless a lender complies with the rules relating to such liens, a lien against crops by the lender cannot be based on the real estate mortgage alone.

The mortgage instrument—default and foreclosure provisions

A typical real estate mortgage includes several terms that require the borrower to do more than merely make the necessary periodic principal and interest payments. For example, the borrower is required to maintain insurance on the premises, pay all real estate taxes when due, and maintain the premises for the benefit of both the borrower and the lender. In addition, mortgages may include a provision prohibiting the sale of all or any portion of the premises without the prior written consent of the lender. Such provisions are known as **due on sale clauses**. If the borrower fails to abide by any of these stated terms, he/she is in **default**.

Once a default has occurred, the lender has several available options. First, the lender can negotiate an arrangement with the borrower by which the borrower conveys the premises to the lender in satisfaction of the underlying debt. Such a procedure is known as the borrower giving the lender a **deed in lieu of foreclosure**. When a borrower undertakes such action, he/she is voluntarily surrendering all of his/her rights in the property, including redemption or reinstatement rights (discussed below). The transfer may also generate significant tax liabilities for the borrower. For these reasons Minnesota courts, for example, have long held that such transactions are subject to close scrutiny to protect the borrower from oppression by the lender. For such an agreement to be upheld by a court, it must not be the result of any oppressive means or overreaching on the part of the lender, and adequate consideration must be given.

A second course of action for the lender is to **bring a lawsuit** on the underlying debt based on the promises of the borrower contained in the promissory note. A mortgage generally will be granted by a borrower to secure the performance of the promises of payment contained in a promissory note. If the value of the real property is less than the amount due under the mortgage, the lender may well elect to bring a **deficiency judgment action** seeking the payment of the amount due under the promissory note. In times of declining agricultural land values, such actions become much more common. Such a course of action, however, may not be attractive to a lender unless the borrower has other nonexempt assets that can be reached to satisfy the underlying debt.

There are two methods of foreclosing a real estate mortgage. **Foreclosure by advertisement** is the most common. An alternative method, **foreclosure by action**, requires the lender to bring an action in court to determine its right to foreclose prior to any foreclosure sale. It is, therefore, more costly and time consuming for the lender and is rarely used, unless the lender wants to secure a deficiency judgment.

A mortgage generally provides that upon a default of the borrower under the terms of the mortgage, the lender has the option to accelerate the indebtedness, foreclose the mortgage, sell the mortgaged premises, and use the proceeds from the sale to pay the debts secured by the mortgage. A mortgage generally includes a provision known as an **acceleration of payments clause**. This clause allows the lender to foreclose without instituting a lawsuit. Without such a clause in a mortgage, the lender must initiate a lawsuit in order to foreclose its mortgage.

Financing the purchase: Contract for deed[5]

The installment **contract for deed** sale is also a popular method of financing the transfer of real estate. With the contract sale, the buyer usually obtains possession of the property for the consideration of a down payment and the execution of a contract for the remaining amount of the purchase price. The seller typically retains the deed or record title to the property until a portion or all contract payments are made.

Under a contract for deed, the buyer acquires an equitable estate in the land. Although it is generally considered that the seller retains record title to the land and is so treated for many purposes, the courts have consistently held that the *seller has a security title only*, and that the buyer is the equitable owner of the property. As such, the relationship is in substance the same as that created by a deed and a mortgage. *However, if a contract for deed is in default, it may provide the buyer with fewer termination remedies than the foreclosure of a mortgage.*

The advantages and disadvantages of using the installment contract are numerous. The buyer who uses a contract for deed can usually purchase real estate with a lower down payment than with a mortgage. Principal and interest payments are often lower as well. A major disadvantage for the buyer is that upon default he/she may lose all equity built up in the property. From the seller's standpoint, the low down payment and the spreading of the income over several years usually results in income tax savings. The contract payments also provide a steady flow of income over a

5. The author wishes to thank Paul Brutlag, Attorney at Law, Elbow Lake, MN, for his help in developing the segment on contract for deed. For a more detailed discussion of Land Contracts, secure a copy of NCR Publication 56 referenced at the back of this publication.

period of years. A major disadvantage of the installment method of sale from the seller's viewpoint is their reduced liquidity. Also, the contract payments do not adjust with inflationary times. Thus, if the seller is dependent on these payments as a source of retirement income, the payments will tend to cover less and less of family spending needs over time, and the seller may even outlive the payments altogether.

Since this is normally a transaction between two (or more) private parties, it is important that a carefully drafted contract be in place, in written form, and properly recorded. This segment first identifies some of the basic terms and conditions that should become part of a workable contract between the buyer and seller. Then some other contract provisions relating specifically to real estate are discussed. The section closes with a discussion of buyer default and related termination options and procedures.

Some basic contract provisions

The contract for deed is a contractual arrangement between buyer and seller, and as such must contain the basic elements of a contract as well as some provisions peculiar to real estate.

These provisions include:

- Names and addresses of buyer(s) and seller(s).
- Legal description of the property.
- The purchase price and terms of the agreement, including: (1) the down payment to be made by the buyer, (2) the length of the contract in years, and (3) the interest rate.
- The amount of the principal and interest payments, including when and where they are to be paid.
- Provision regarding partial or full **prepayment** of the contract amount, including how these additional payments will be applied to the remaining portion of the contract.
- If there are buildings, improvements, and/or a house involved in the transaction, an allocation of the overall purchase price should be made for tax and insurance purposes.[6]
- A provision regarding payment of real estate taxes and special assessments should include: (1) the seller warrants that such payments are paid-to-date, (2) who is responsible for such payments during the year in which the contract is dated, and (3) that the buyer will timely pay all future taxes and special assessments during the course of the contract.
- A provision regarding the title the seller warrants including any conditions, restrictions, liens or encumbrances that exist, and how they will be handled by seller.
- With the growing stress on environmental aspects such as wells, septic tanks, and land use, the seller should certify that no such hazards exist. (See discussion of environmentally related issues earlier in this chapter).
- Include a statement that, upon the timely and full performance of this contract, the seller will deliver to the buyer the deed of property, subject to any special provisions, as well as an abstract of title.

Care of property; property and liability insurance provisions

Careful consideration should be given to provisions relating to the care of the property and related property and liability insurance provisions.

- Include provisions relative to the removal, demolition and repair of buildings. Also, that the buyer will not permit liens to accrue or adverse claims to exist against the property.
- Buyer and seller should agree as to the risks to be insured against and the amount of coverage on property. Other provisions include to whom proceeds of the loss will be paid, notification of loss, and the application of insurance proceeds.

6. For a detailed discussion of tax issues in buying or selling a farm, see NCR-43, referenced at the back of this publication.

- Provisions relating to liability should include: (1) that the seller is free of liability for injuries occurring on the property and that the buyer will defend the seller from any such claims, and (2) that the buyer will pay for such insurance in amounts agreed to by the seller.

Assignment; sale or transfer of property provisions

- If either party assigns their interest in the property, the other party of the contract should be notified promptly.

- The buyer has no right to assign any portion of this contract agreement without prior written consent of seller.

- If the buyer contemplates the sale or transfer of any portion of the contract property, this should be agreed upon and made part of the contract agreement.

- It is important that a **due-on-sale clause** be made part of the contract agreement. Then, if the buyer sells or transfers any portion of the property without the seller's prior written permission, the due-on-sale clause would take effect. This clause states that, at the seller's option, the seller declares the sums secured by this contract be immediately due and payable.

Provisions to protect seller's and buyer's interests

It is important that both the seller and buyer be able to protect their interests in the property from any action or inaction by the other party. The following are some possible provisions that might be included in a contract agreement.

- If the buyer fails to pay any sum of money required under the terms of this contract or fails to perform any of buyer's obligations, as set forth in the contract, seller may, at seller's option, pay the same or cause the same to be performed, or both, and the amounts so paid by seller and the cost of such performance shall be payable at once by buyer to the seller. (This would include taxes, special assessments, insurance, repairs, etc.)

- An often overlooked problem area is where the underlying property has a mortgage or lien against it *that the seller is responsible for*. The following are examples of provisions that would protect the buyer's interest from such claims.

a. If there now exists, or if seller hereafter creates, suffers or permits to accrue any mortgage, contract for deed, lien or encumbrance on the property which is not herein expressly assumed by the buyer, and provided buyer is not in default under this contract, the seller shall timely pay all amounts due thereon.

b. If the seller fails to do so, the buyer may, at buyer's option, pay any such delinquent amounts and deduct the amounts paid (or cure any resulting defaults) from the installment(s) next coming due under the contract.

Default and termination procedures

As illustrated above, the typical contract for deed includes several terms that require the buyer to do more than make the necessary periodic payments. For example, the buyer is required to maintain insurance on the property, pay all real estate taxes, and special assessments, and to maintain the property for the benefit of both seller and buyer. If the buyer breaches any of the terms in the contract, he/she is in default. Once default has occurred the seller has three broad options:

Option 1. Deed in lieu of termination

The buyer conveys his/her interest in the property to the seller in satisfaction of the underlying debt. Such a procedure is known as the buyer giving the seller a **deed in lieu of termination**. When a buyer undertakes such action, he/she is voluntarily surrendering all of his/her rights to the property, including redemption or reinstatement rights. The transfer may also generate significant tax liabilities for the buyer. For these reasons, courts have long held that such transactions are subject to close scrutiny to protect the buyer from undue influence by the seller. Some states provide buyers with certain termination rights and first refusal rights. The state law where the property is located should be researched.

Option 2. Lawsuit by seller to recover buyer's interest in the property

With this option, the seller brings a lawsuit for termination of the contract and the return of the buyer's interest in the property to the seller. From the seller's standpoint, it is important that the contract contain an **acceleration of payments clause**. Absent such a clause, the seller may be required to sue for each installment payment as it comes due.

Option 3. Lawsuit by seller against underlying debt

A third course of action is for the seller to bring a lawsuit against the underlying debt (the remaining contract payments plus interest due), based on the promises of the buyer contained in the contract. If the value of the real property is less than the amount due under the contract for deed, the seller may well elect to bring an action seeking payment of the total amount due.

Closing Comments on Default Provisions

Work with an attorney(s) to get the proper default provisions in the contract agreement. The following **acceleration upon default** provisions may be helpful as the attorney drafts default provisions.

- If any installment under this contract is not paid when due and remains unpaid after a date specified by notice to the buyer, the entire principal amount outstanding and accrued interest thereon shall at once become due and payable at the option of the seller.

- The date specified shall not be less than _____ days (by state law) from the date such notice is mailed. The seller may exercise this option to accelerate during any default by the buyer, regardless of any prior forbearance by the seller.

Worksheet 2-2. How much is this farm/parcel worth to the manager/business?

Projected gross income/acre	Crop ______	______	______	
Expected yield	______	______	______	1
Expected price (cash or loan)	$ ______	$ ______	$ ______	2
Crop income (1 x 2)	______	______	______	3
Other income (gov't payments, straw, etc.)	______	______	______	4
Projected income/acre (3 + 4)	$	$	$	5

Projected direct expenses/acre				
Seed	$ ______	$ ______	$ ______	
Fertilizer	______	______	______	
Chemicals	______	______	______	
Crop insurance	______	______	______	
Custom hire	______	______	______	
Fuel, oil	______	______	______	
Drying, utilities	______	______	______	
Repairs	______	______	______	
Seasonal labor	______	______	______	
Operating interest	______	______	______	
Projected direct expenses/acre	$	$	$	6

Projected net return over direct expenses				
Projected/acre return over direct expenses (5-6)	______	______	______	7
Acres of each crop	______	______	______	8
Projected net return each crop (7 x 8)	______	______	______	9
Total net over direct expenses (total line 9)			$	10

Projected overhead charges to above acres		
Operator labor and management	$ ______	
Machine depreciation/replacement	______	
Real Estate Taxes $ ______, Insurance $ ______, Maintenance $ ______	______	
Other overhead	______	
Projected total overhead charges	$	11

Projected residual return/estimated value		
Projected total residual return to cropland (line 10-11)	$ ______	12
Capitalization rate (e.g. 5% = 0.05)	______	13
Capitalized value of cropland (12 ÷ 13)	$ ______	14
Sensitivity analysis: capitalized value if:		
Higher residual return $ ______ ÷ Lower cap rate ______	$ ______	15
Lower residual return $ ______ ÷ Higher cap rate ______	$ ______	
Capitalized value of cropland (line 14 or 15)	$ ______	16
Adjustments for: location , buildings, house	______	17
Pasture, woodland; ______	______	18
Estimated total value of farm/parcel (16 + 17)+18)	$	19
Per acre (19 ÷ 8)	$ ______	

Instructions for worksheet 2-3

When filling out Worksheet 2-3, be sure to put the correct sign in front of the adjustment figures so that they will add up to a final adjustment price per acre for the subject farm relative to each comparable sale property. Remember the rule: add when the subject farm has the advantage.

Time of sale. Obtain sales data for recent years for the area in order to make adjustments for the time of sale. For example, a sale made in 1998 would normally have to be adjusted upward slightly to make it comparable to a 2000 sale.

Effect of size. Small farms usually bring a higher per-acre price than large farms because they tend to attract more potential bidders. However, if tracts become too small or fields are irregularly shaped, per-acre bid prices drop because of higher machinery costs in operating the farm. What is considered "small" or "large" varies. In Minnesota, for instance, the average size of farm and machinery used is much larger in the Red River Valley than in the southeast, or near the Twin Cities.

Land Quality and Utility. A study of land values in the state will indicate the great variability that can be found in land prices because of land productivity differences in various areas of the state. The percentage of acreage that is tillable and the percentage of acreage with highly productive soil types are the two most important variables affecting the productive capacity of a farm. Before making an adjustment relative to the comparable sale property for the productivity factor, study NRCS maps to compare the comparable sale farm with the subject farm. Also contact the local Farm Services Agency office and/or operators and neighbors familiar with the historical crop yields on the farm. Divide tillable land into at least three productivity classes, and adjust the average per-acre value based on price variation among classes. Adjust for differences in the proportion of tillable land on the comparable sale farm and the subject farm. Use these two adjustments to fill in the productivity line in Worksheet 2-3.

Buildings and improvements. Since buildings and improvements cannot normally be sold separately from the farm, their added value is usually considerably less than replacement costs minus depreciation. The appraiser must examine comparable sales closely to estimate what the market is actually "paying" for existing farm buildings. Sometimes buildings actually detract from the average market price of farm property. For many years this has been observed for farm sales in the Red River Valley of Minnesota. Yet in the dairy belt of central Minnesota, good dairy buildings can add a significant amount to the sale value. It takes an experienced appraiser who examines many comparable sales to determine what the market is actually paying for farm improvements.

Location, Access. The quality of roads and distance to markets, schools, churches, and shopping centers are important in evaluating location. Determine how each of the sales used in the comparable sales approach would have been affected had the farm been located in the same place as the one being appraised. Again, past experience as well as sound judgment will be necessary to make the appropriate adjustment.

Sale Terms, Conditions, Other factors. Several other adjustment factors should be considered before totaling the adjustments. These factors include:

- Whether or not the farm was sold on a contract for deed.
- The interest rate charged.
- Whether there are any special encumbrances on the deed.
- Whether it had proportionately greater or smaller acreage allotments for crops such as sugarbeets, corn or wheat.
- Or whether any other unusual factors might have influenced the market price. If the

comparable farm is too unusual in some of these aspects, it should not be used in the comparable sales approach.

- **Determine the apparent market value of subject farm.** Then make a judgement as to the apparent market value of the subject farm. The "comparable value of subject farm," line in the worksheet represents an estimate of the market value of the subject farm based on a comparable sale at a previous time. Analyze several comparable sales before deciding which are the best indicators of the "apparent market value of the subject farm"—the last line in the worksheet.

Worksheet 2-3. Comparing market value of subject property with other sale properties.[a]

Sale no.	Example	1	2	3	4
Purchaser	Freeman				
Date	7/98				
Size	160				
Sale price	$1,000	$			
Adjustments on per acre basis[b]					
Time (adjustment)	$ 0	$			
Effect of size	0				
Land quality & utility	+100				
Buildings & improvements	-30				
Location, access	+60				
Sale terms, conditions	+25				
Other	0				
Total net adjustments	$ +155	$			
Comparable value of subject farm					
Sale price (above)	$ 1,000				
Net adjustment	$ +155				
Comparable value of subject farm	$ 1,155	$			
Apparent market value of subject farm					$

[a] Adapted from worksheet supplied by Rick Hauge, Accredited Rural Appraiser, Redwood Falls, MN.

[b] Use a plus sign if the subject farm has an advantage over the other sale property and a minus sign if it has a disadvantage.

Worksheet 2-4. Can debt repayment demands be met?

Estimate annual net cash earnings from farm/parcel

Residual returns to crop land (line 12, Worksheet 2-3)	$______	1
Rent from buildings, pasture, etc.	$______	2
Total expected net cash earnings (1 + 2)	**$______**	3

Calculate the amount of debt that can be serviced

Debt repayment factor - (see table below)	(Factor)______	4
(expected loan terms: ______years, ______interest rate)		
Total debt that can be serviced (3 x 4)	**$______**	5

Determine whether repayment demands can be met

Current asking price for farm/parcel	$______	6
Down payment needed (6-5)	$______	7
Down payment funds available (exclusive of borrowings)	$______	8
Short fall in down payment (7- 8)	$______	9
Annual cash flow deficit (9 ÷ 4)	$______	10
Subsidy: cash available from other sources (other enterprises, off-farm income)	$______	11
Cash flow surplus or (deficit) (11-10)	**$______**	12

If line 12 is negative, determine under what conditions debt payments could be met

Reduction in asking price needed to meet debt payments (12 x 4)	$______	13
Or change in finance terms needed: (line 17)		
Total debt to be serviced (6 - 8)	$______	14
Annual cash flow available (3 + 11)	$______	15
Resultant debt repayment factor (14 ÷ 15)	(Factor)______	16
Determine finance terms needed: years to repay (see table below)	(years)______	17
Interest rate (see table below)	(%)______	

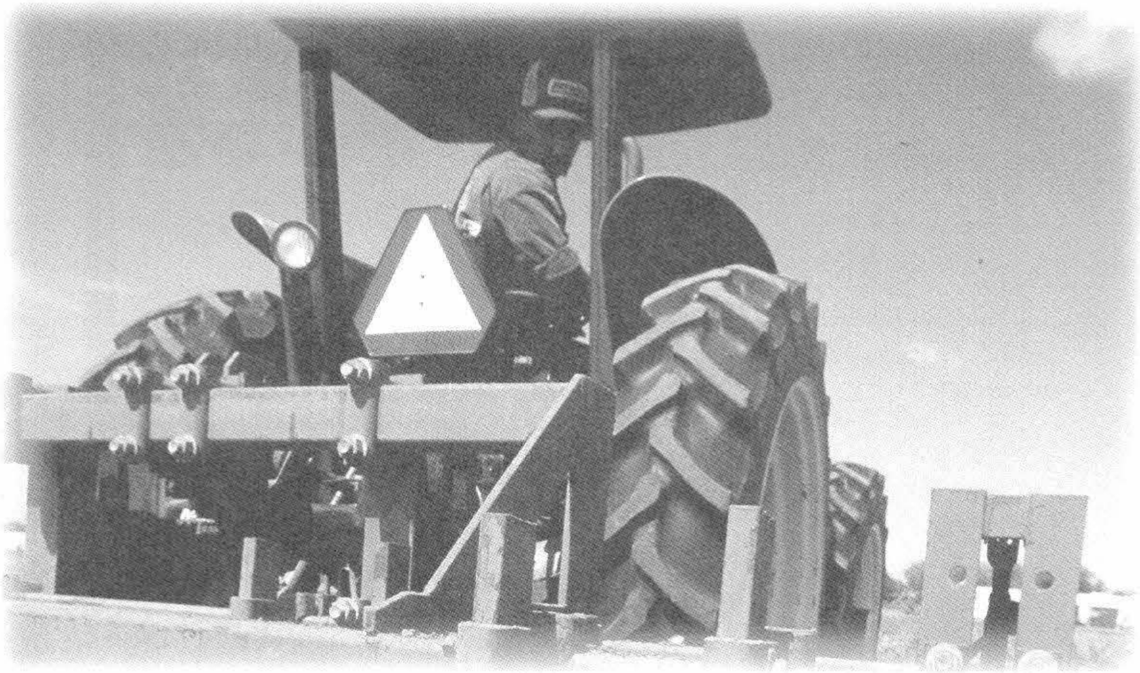
Debt Repayment Factors For Lines 4 and 16.
(amount of debt $1 per year will cover; equal annual payments bases)

Repayment period In years	Interest rate 6%	7%	8%	9%	10%	12%
10	$7.4	$7.0	$6.7	$6.4	$6.1	$5.7
15	9.7	9.1	8.6	8.1	7.6	6.8
20	11.5	10.6	9.8	9.1	8.5	7.5
25	12.8	11.7	10.7	9.8	9.1	7.8
30	13.8	12.4	11.3	10.3	9.4	8.1
40	15.0	13.3	11.9	10.8	9.8	8.2
forever (interest only)	16.7	14.3	12.5	11.1	10.0	8.3

Managing the machinery system

3

- Developing machinery cost budgets
- Making individual machinery replacement decisions
- Making system-wide machinery selection decisions
- Deciding how to acquire the use of machinery services
- Incorporating machinery and labor components: Some advantages
- Monitoring and adjusting a machinery system



Machinery and equipment represent a major investment and cost item in the typical crop production system. This chapter first discusses the process of budgeting machinery costs and making individual machine replacement decisions. Then the process of making system-wide machinery selection and acquisition decisions is covered. Next, is a discussion of the advantages of putting machinery and labor in a separate services corporation. The chapter closes with a discussion of monitoring and adjusting a machinery system.

Developing machinery cost budgets

Modern farming technology often requires the use of large, expensive machinery. Owning and operating this machinery is a major component of total farm expense. To make informed decisions about individual machines, a manager must first know the costs of current machinery and of any alternatives being considered. Machinery costs are typically classified into two categories: ownership and operating costs. As shown in Worksheet 3-1, **ownership costs** include depreciation, interest on average investment, personal property taxes, if any, insurance and housing. **Operating costs** include fuel, oil, filters, repairs, labor, and other associated costs. The total average annual cost of owning and operating a machine is the sum of these two cost categories. Costs can also be expressed in machine cost per hour or per acre.

Worksheet 3-1. Estimating costs of owning and operating an individual machine.[a]

Machine ______________ New cost $ ______________

Estimated life ______________ years Salvage value $ ______________

Annual use ______________ hours, acres

	Annual cost	Cost per hour or acre	
Ownership (fixed) costs			
Depreciation	$______	$______	
Interest on investment	______	______	
Taxes	______	______	
Insurance	______	______	
Housing	______	______	
Total ownership costs	$______	$______	1
Operating (variable) costs			
Fuel: ______ gallons multiplied by $______ per gallon	$______	$______	
Engine oil, lubricants, filters	______	______	
Repairs (parts, tires, labor)	______	______	
Operating labor: ______ hours multiplied by $______ per hour	______	______	
Other costs (twine, wire, etc.)	______	______	
Total operating cost	$______	$______	2
Total machine cost (1 + 2)	$______	$______	3

[a] Source: Castle, Becker and Nelson, *Farm Business Management*, Macmillan Publishing Company, New York, Third Edition, 1987, page 334.

Making individual machinery replacement decisions

The most common individual machine-related decisions a manager has to make are: (1) when to replace a machine (2) whether to buy a new or used machine, and (3) whether to own, rent or custom hire. Item 3 will be discussed in a later segment of this chapter. Use machinery cost budgets and/or the partial budgeting and capital budgeting procedures (see Chapter 1 Part III) in making the analysis.

Deciding when to replace a machine

Farmers have various reasons for replacing machinery—some economically sound and some related to other factors. These include:

- Ownership and operating costs are greater than alternatives.
- The current machine is undependable.
- The machine is obsolete.
- The machine capacity is too small.
- Tax implications.
- Non-economic factors such as having "new paint" around the place.

From a purely economic standpoint, the first step is one of determining when the cost of owning and operating a present machine will likely become greater than the costs associated with a replacement machine. As a general guideline, replacement should be considered after a machine has reached half of its normal life. Thus, the analysis should focus particularly on on-going repair costs and the potential need for a major overhaul.

But, as indicated at the outset, there are other important factors to consider such as reliability, obsolescence, income tax considerations, credit availability and personal preference. Though these decisions are complex, they not only involve large investments and affect the cost structure of a business, they can also affect timeliness, labor efficiency, and resultant crop yields.

Deciding whether to purchase new or used machinery and equipment

A related issue when replacing a machine is whether to buy a new or used machine. Farmers are frequently faced with this decision. Again, the correct decision depends on each individual farmer's circumstances. There are, however, certain considerations that must be taken into account. For example, purchasing used equipment is one method of reducing investment in machinery. Some farmers do not have the problem of allocating limited capital, but most farmers do. Buying used machinery may be a more efficient use of limited capital particularly for the beginning farmer or for those in a marginal financial situation. It may also be a viable alternative where the machine is to serve as backup in the machinery system.

In general, buying used rather than new equipment results in higher variable costs relative to fixed costs. Depreciation, interest on the investment, and insurance costs are higher on new equipment. Repairs, fuel and lubrication costs and labor are usually higher with used equipment. Used machinery is generally less dependable than new, and breakdowns may reduce the quantity and/or quality of the crop. Thus, *the manager's ability to buy good used equipment and to make needed repairs* are important determinants as to whether one should buy new or used equipment.

New machines are often more convenient and efficient. They have features that may not add greatly to output, but make them more enjoyable to operate. Also, satisfaction is often gained from using new equipment. Put another way, the prestige value of a new machine is greater. *But, more than one farmer has been forced out of business because of their strong desire to own large machines with new paint.*

Again, the place to start in making this new-versus-used decision is in estimating the annual cost associated with the new and used machines. Table 3-1 provides an example of the potential costs associated with a new and a used combine.

As shown in Table 3-1, the used combine has an annual ownership cost slightly lower than for the new one. A manager should also consider the potential lowering of harvest yields or crop quality because of the lower dependability factor associated with the used combine.

There are risks involved in purchasing used machinery. Even though the manager/purchaser is mechanically inclined, there is no way of reducing the underlying uncertainty. First, try to determine why the machine is for sale. Used machinery is usually put on the market for three main reasons: (1) the machine no longer meets the seller's dependability needs; (2) the machine no longer meets the needs of the operation, or (3) the machine is no longer needed.

Second, deal with a reputable source such as a local machinery dealer or a neighbor. Of course, the overriding factor may be one's present debt/asset ratio and whether loan money is available. One may have to lease or rent a combine or custom hire the work done.

Table 3-1. Estimated annual ownership cost of owning a new or used combine.

	New	Used
Original cost	$100,000	$60,000
Expected life	Ten Years	Six Years
Annual depreciation	$9,800	$9,600
Interest (12%)	6,120	3,744
Repairs	2,000	3,600
Insurance	200	140
Taxes	740	460
Total annual ownership cost	**$18,860**	**$17,544**

Making system-wide machinery selection decisions[1]

Often when major changes occur in the crops grown and/or the way they are grown, harvested and handled, a system-wide change in machinery may be necessary. Following is a discussion of the factors to be considered in making a system-wide decision, and a discussion of the procedures to use in making the analysis and decision.

Factors to be considered

It is very difficult to put together an ideal machinery system. Determining the number and size of trucks, tractors, combines, and other equipment to have is closely linked to other resources involved in the operation. For example, is there too much machinery relative to the land and labor available? Or would it be more profitable to vary land or labor to utilize a given set of machinery? Two other factors add to the complexity of the machinery system decision process. First, machinery is acquired in relatively large indivisible units, as it is not possible to purchase half a truck or a third of a combine. To further complicate things, equipment that works well one year may not work well the next because of changes in weather conditions, cropping practices, crops grown and the acreage involved.

As a result, selection of a machinery system often involves taking stock of the whole farming enterprise. Thus, if one is at a crossroad with a machinery system, and/or other farming enterprises, refer to relevant chapters of Part I of this series. It is often necessary to develop a whole farm plan by working from the "enterprise" level up. There are several factors that influence machinery selection decisions.

Machine performance—doing the job

First of all, each piece of machinery must perform adequately and reliably under a variety of conditions or it is a poor investment. Many times the performance of a machine depends on the skill level of the operator or on weather and soil conditions. Nevertheless, differences among machines can be evaluated through field testing, research reports, and personal experience of trusted sources.

Factors affecting machine size requirements

Once a particular type of tillage, planting, weed control or harvest machine has been selected, the question of machine size must be answered. Machinery which is too large for a particular farming situation will cause unnecessarily high machinery costs over the long-run. On the other hand, machinery which is too small may result in lower crop yields and higher labor costs.

Machinery size selection must be based on the characteristics of each individual farm. The following factors influence this selection process.

- **Number of crop acres operated**. As more crop acres are farmed, larger scale machinery is often needed to ensure that planting and harvesting are completed in a timely fashion. If an additional tractor and operator are available, acquiring a second unit may represent a lower cost alternative. Also consider the number of acres one will be farming in the future so the machinery system will also accommodate future needs.

- **Labor supply**. The number of acres that can be completed each day is a more critical measure of machine capacity than machine width or acres completed per hour. Increasing the labor supply by hiring extra operators or by working longer hours during critical periods, may be relatively inexpensive ways of stretching machinery capacity. In addition, the cost of additional labor is only incurred when it is actually needed, while the overhead cost of investing in a larger machine becomes "locked in" as soon as the investment is made. On the other hand, the extra labor may not always be available when needed.

- **Tillage practices**. The number of field days required to complete planting depends partly on the number of separate operations required on each acre and whether more than one operation can be performed during a given trip across the field. Obviously,

1. This discussion is adapted from *Farm Machinery Selection*, by William Edwards, et. al.,Pm 952, Iowa State University, 1985.

less time required to prepare a given field will reduce the size of equipment needed. But these cost savings must be compared to possible increased chemical costs and possible effects on yields.

- **Crop mix.** Diversification of crops tends to spread out the periods when timely completion of field operations is critical. Growing more than one crop often reduces the amount of machinery capacity needed for a given number of crop acres. However, it may also require purchasing additional types of machinery, especially for harvesting. Also, the returns on these added crops may not be as high as for the highest-return crop.

- **Weather patterns and variability.** Weather patterns determine the number of days suitable for field work in a given time period each year. Although actual weather conditions cannot be predicted far enough in advance to be used as an aid in machinery selection, past weather records can be used as a guide as to the number of suitable field days one could normally expect during a given period. Machinery selection should be based on long-run weather patterns even though it may result in excess capacity in good years and insufficient capacity in bad years.

- **Risk bearing ability and preferences.** Fluctuations in the occurrence of suitable field days from year to year causes timeliness costs to vary even when the machinery set, number of crop acres, and labor supply do not change. Investing in larger-sized machinery can reduce the variability of total machinery costs by ensuring that crops are planted and harvested on time even in years that have few good working days. Machinery fixed costs would be higher with larger machinery, but they would not fluctuate as long as the machinery set did not change. Farmers with high fixed cash flow needs, such as mortgages and other debt payments, may be willing to pay more in higher machine costs than other operators for the "insurance" of not suffering substantial yield losses due to late planting and harvesting in certain years.

Analyzing alternatives; making the decision

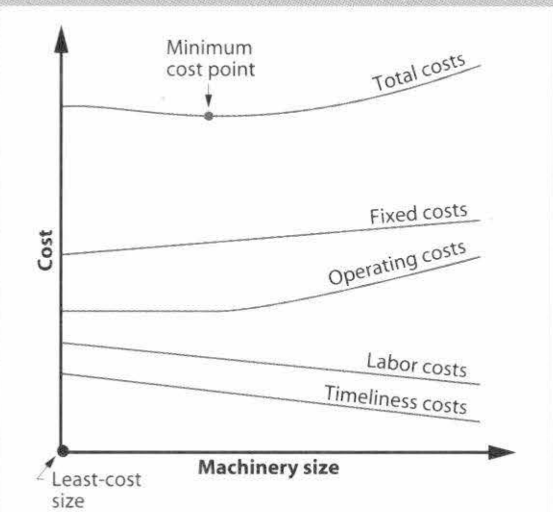
The above discussion illustrates the complexity of making machinery selection decisions. There are a number of factors to consider, and several are hard, if not impossible, to measure. Therefore, it is best to use simplified analysis procedures, such as a partial budget, that consider both profitability and repayment capacity. (See the discussion of the partial budget in Chapter 1 Part III.) Several different comparisons should be made to determine the sensitivity or impact of selected sizes of machinery or assumptions as to field days, etc., on profitability and cash flow.

Analyzing measurable factors

First make estimates of what would likely happen to ownership and operating costs, as well as labor and timeliness costs. Figure 3-1 illustrates the typical relationship between these costs, and between machine size, and total machine costs for the year.

Generally speaking, machine operating costs will remain fairly constant over a wide range of machine sizes, while ownership costs will increase as machine size increases. Labor and timeliness costs, on the other hand, tend to decline as machine size increases. Thus, there is a basic trade-off between ownership, labor, and timeliness costs.

Figure 3-1. Effect of increasing machine size on machine-related costs.



Deciding: Considering measurable and unmeasurable factors

In an ideal world, one would select the machine size that represents the lowest cost set. But a manager must also consider other hard-to-measure factors such as weather variability and one's personal risk-bearing ability. If the business is likely to enter a growth period, then machinery size purchases should also reflect such a possibility. It may also be desirable to custom hire or lease selected pieces of machinery if the business is in transition or in a difficult financial situation.

Deciding how to acquire the use of machinery services

Acquiring farm machinery services means gaining control of a machine long enough to accomplish some task in the farm business. It is the final step in the process of selecting machinery.

Some key questions in deciding how to acquire the use of machinery

After deciding what type of machine or machinery system is needed and how large it should be, answer the following questions before deciding how to acquire its services.

- Are the ability, tools, and extra labor required to operate the machine properly and to maintain it in an efficient and reliable condition available?

- How much risk is involved in purchasing the machine? For example, how likely is it that production practices will change in the near future so the machine is no longer needed? Are current technological developments likely to make the machine obsolete before it's time to sell it?

- How much capital will be needed to purchase the machine? Is that much investment affordable? Can the payments be made? What will be the machine cost per acre to own and operate? Is investment capital needed in other areas of the business? How much will it earn there?

- What other ways are available to acquire the machine's services? How much capital will they require? What are their expected costs? Are there advantages or disadvantages compared to ownership? What is the after-tax cost of each method?

Alternative methods of acquiring the use of machinery

There are several ways of acquiring the use of a full line of machinery and equipment including:

- Full ownership.
- Joint ownership or exchange work.
- Custom hiring.
- Short-term rental.
- The financial lease.

Full ownership

Ownership is the most common method of acquiring long-term control of farm machinery services. By owning a machine, one gains complete control over its use and has all the responsibilities that go with it, i.e. labor to operate it; repairs and maintenance; liquidation and obsolescence; and some of the investment capital is no longer available for other uses in the farm business. Complete control over machine scheduling and the quality of its performance is gained.

Machinery and equipment purchases are typically financed using an intermediate-term loan. Such loans range in length from one to 10 years, though a five to seven year term is most typical. Dealing with a borrower who has a solid reputation and who has demonstrated ability to repay such loans is the best protection a lender can have. Lenders require a borrower to put up some collateral—usually the machine or equipment being purchased—to secure the loan. The seller may also provide the necessary financing and retain a claim to the property. Such a security interest is referred to as a **purchase money security interest.**

In most cases, however, in order to give a lender an adequate security interest, the borrower must sign a **security agreement**. Such a security agreement is valid and enforceable if: (1) it is in writing and signed by the borrower, (2) it is collateral in which the borrower has an ownership interest (it must contain a description of the property), (3) the lender gives value (loan funds) in exchange for the security interest. For more on security interests, see Chapter 4 Part II.

Joint ownership or exchange work options

- **Joint ownership** distributes responsibility for investment, repairs, and labor among two or more parties. It may generate enough use to make a machine cost effective that would not be for either party alone. And two parties may be able to make the payments together without either party having a short-term cash flow deficit. *But cooperation is absolutely essential.* The parties must approve of each other's work habits and care of the machine. Work out scheduling of operations between farms ahead of time. Responsibility for operating labor and repairs should also be agreed upon. Most important, a **written agreement** should be signed by both parties with details of: (1) how the co-ownership will be dissolved in case of disagreement, the termination of farming operations by one party, or death of one party; and 2) the method to be used in determining the machine's value at the time of dissolution.

- **Exchange work** with a neighbor is one of the oldest forms of short-term acquisition of farm equipment. Two or more farmers, working together to share labor and equipment, can reduce their individual investments in machinery and still have access to a complete system. Exchange work may be particularly attractive to a younger farmer starting operations with an older neighbor: one needing machinery and the other needing labor.

  Exchange work requires some organization if it is done very frequently, and the parties involved must be compatible. Whose farm is first when a machine is going to be used on more than one farm? Who operates the machine? Who pays repair costs when the machine breaks down and someone other than the owner is using it? How many hours of labor are equivalent to an hour of machine time?

Custom hire

With custom hiring, the farm operator and/or landowner hires a custom operator to do one or more field operations. The custom operator provides the machine(s), labor and fuel, and agrees to perform selected operations at a specified cost. The number of field operations done by a custom operator can vary from one or two operations, such as fertilizer spreading or combining, all the way to a situation in which the custom operator does all of the field operations for a given crop or crops on a given farm.

- **Custom hiring selected operations.** Custom hiring is particularly useful in gaining the use of specialized machines that are too expensive to purchase when used only occasionally. This method is attractive to beginning farmers and small scale farm operations as well as for established operators who are expanding and have other uses for their capital and work force. Typically, there are no written agreements involved in custom hiring. Thus, it is crucial that one select a competent operator who will do a quality and timely job. The custom operator needs to be concerned about the farm owner's ability to pay. Also, agree upon a custom charge *before* the operations are performed.

- **Custom hiring/custom farming**. With this arrangement, the landowner (in some cases a farm operator) hires a custom operator (or operators) who agrees to perform most if not all of the field operations on the landowner's land for a set fee or custom rate. The term currently in use for this arrangement is **custom farming**. The landowner also pays for all of the seed, fertilizer, chemicals, and other cash costs and receives all of the crop. It is sometimes used by landowners who want to get more involved in farming operations than under a cash or crop share lease. Or, in some cases, a full time farm operator, specializing in livestock, may not want to own machinery or allocate the time to the cropping enterprise.

Before entering a custom farming situation, develop a well thought out agreement and put it in writing. The agreement should indicate the:

- Location and acreage involved.
- Names of the parties and the legal arrangement involved.
- Scope of the agreement.
- Custom services expected of the machine operator.
- Landowner's obligations and negotiable items.
- Schedule of custom rates and payment plan.
- Provision for default, acts of God, and disputes.
- Signatures of parties to the agreement.

Short-term machinery rental

The short-term rental option is one in which the farm operator rents a piece of equipment for a specified period. This arrangement differs from custom hire in that the farm operator will actually be doing the operations, and thus is responsible for the quality and timeliness aspects. He/she will also be responsible for daily maintenance of the machines. There are generally two rental options: **pure rental** - the farm operator never gains ownership of the machine; and (2) **rental-purchase**. In the latter arrangement, take care to ensure that the IRS views the arrangement as a rental rather than a conditional sales contract. Failure to do so can result in some unexpected income tax consequences.

The commercial financial lease

This method of leasing machinery provides a way to gain access to a machine over a long-term period, e.g. five to seven years. In many instances, the yearly lease payments are less than the payments if one borrowed money to own the machine. But since the lease usually extends for a period of years longer than the debt payment route, the *total* amount paid may exceed the ownership route.

It should also be noted that leasing machinery and equipment from a commercial firm may prove to be risky business. For example, if the leased property proves to be defective, it may be much more difficult to enforce any warranty claims against the lessor or dealer. The UCC provisions dealing with implied warranties do not, in the case of a bona fide lease, apply to defective leased property. Besides warranty difficulties, the lease may provide that, in the event of default, the lessee will not only lose possession of the leased property and recover none of the payments made to date, but may also be held liable for the balance of the lease payments. The lease may also provide that, in the event of a default, the lessor may repossess the property without notice or resort to the courts.

In addressing these issues, many courts have held that arrangements bearing the lease label are, in fact, disguised security interests or conditional sales contracts. The question of whether an arrangement is a true lease or a sales contract must be determined by the facts and circumstances of each case. As a general rule, however, inclusion of a provision in the lease that allows the lessee to purchase the property at the termination of the lease for little or no additional consideration, will be construed by a court as conclusive evidence that the arrangement is, in fact, a sales arrangement. If found to be a conditional sales contract, the provisions of the UCC with respect to security interests and termination of security interests may apply in the event of a default. In addition, the provisions of the UCC dealing with warranties may be triggered. See Chapter 4 Part II for a further discussion of these issues.

Summary comparison of alternative methods of acquiring farm machinery services

Table 3-2 provides a very useful summary comparison of the machinery acquisition methods discussed. For each method it indicates:

- What income tax deductions and credits are involved.
- The capital outlay required of the farm operator.
- Cash flow requirements.

Table 3-2. Summary of major characteristics of alternative methods of acquiring farm machinery services.[a]

Method of acquisition	Income tax deductions and credits	Capital outlay required for investment	Cash flow for operation and acquiring services	Repairs and maintenance cost	Operating labor	Control over use and timeliness of operation	Risk of obsolescence
Ownership:							
Cash purchase	Depreciation operating costs	Full cash cost	Operating costs	Full cost	Supplied by farm operator	Full control	Full risk
Credit purchase	Same, plus interest payments	Down payment	Operating costs plus loan payments	Full cost	Supplied by farm operator	Full control	Full risk
Custom hire:							
	Custom charges	No investment capital required	Custom hire cost	No cost	Supplied by custom operator	Limited control over timeliness–availability can be a problem	No risk
Short-term rental:							
	Rental fees	No investment capital required	Operating costs plus rental fee	Limited cost depending on agreement	Supplied by farm operator	Availability can be a problem	No risk
Long-term lease:							
Financial lease	Lease payments	No investment capital required	Operating costs plus lease payment	Full cost	Supplied by farm operator	Full control	Low risk
Conditional sales contract	Depreciation, operating costs	No investment capital required	Operating costs plus lease payment	Full cost	Supplied by farm operator	Full control	

[a] Source: *Acquiring Farm Machinery Services*, by William Edwards, Iowa State University, Pm 787. Revised September 1986. 6 pages.

- Responsibility for repairs and maintenance costs.
- Who supplies the labor to operate the equipment.
- The degree of control the farm operator has over machine use and timeliness of operation.
- Who bears the risk of obsolescence.

Incorporating machinery and labor components: Some advantages

Managers of larger, multi-owner farm businesses may find it desirable to establish a separate machinery/labor corporation which would charge the operating entity a use charge. There are several advantages of such arrangements:

- With multi-owners, it simplifies the task of keeping track of machine ownership in that each owner would own shares of stock and not individual machines. It provides a separate cost center and thus better records can be kept and cost allocations will be more accurate.
- It limits the risk exposure of the owners. Machines can cause injuries and operators

can get injured or subject the business to liabilities because of their actions.

- Licensed vehicles can be placed in the corporation and thus limit the risk exposure of accidents occurring on the highway.

- If the corporation is set up as a C corporation, there would be a separate tax entity, and would provide the opportunity to utilize the lower tax brackets associated with certain income levels of a corporation.

But here again, full benefit of such an approach will be possible only if the manager(s) is willing to expend the effort needed. This will include managing a separate set of accounts, separate bank accounts, and separate income tax returns. Managers will have to determine if the increased overhead costs related to the operation of an additional separate entity are offset by the potential liability protection, the separate enterprise productivity, and the potential income tax advantages.

Monitoring and adjusting a machinery system

As part of the planning process, decide the types of records to keep in order to adequately manage the machinery system and make needed adjustments. There are three broad types of machine-related records that might be kept: (1) depreciation and fair market values of each machine for use in tax reporting and machine replacement; (2) individual machine repair and maintenance records; and (3) machine use and related operating costs and labor use.

Depreciation and fair market value records

For tax purposes, keep a record of the date of purchase, the purchase price and whether the machine was new when purchased. This type of information should be kept as part of the depreciation schedule to justify the depreciation taken and to determine the extent of depreciation recapture involved upon resale of the machine.

Also consider developing a procedure for estimating the fair market value of each machine on an annual basis. Such a value would allow the owner to: (1) compare fair market and depreciation value, and (2) more easily determine the tax impact of trading versus selling outright when making replacement decisions.

Repair and maintenance records

Keep individual records on each machine indicating when repairs and maintenance were done on the machine, the cost of parts, etc., and the labor involved. The record should also include likely future repair and maintenance needs, if the machine should be traded, etc.

Machine and labor use and operating expense records

Machine and labor use records can be an important management tool. These records would indicate how much use is being made of each machine and the amount of labor involved.

It is also important to keep accounts of operating expenses, such as fuel and oil. This system might include a chart placed at the fuel pump to record the date, the machine number and hours of use, the amount of fuel used, and the labor used.

Farm personnel—Planning and staffing

4

- Work force planning
- Staffing: Recruitment and selection

As the size and complexity of farm businesses continue to increase, managing farm personnel is an increasingly important function of farm managers. As indicated in Figure 5-1 of Chapter 5, a manger has more than a dozen specific responsibilities once hired employees and family members become involved in the business. Responsibilities range from planning for, hiring, managing and firing people, to keeping up with the laws and regulations relating to farm personnel.

This chapter focuses on two key responsibilities: work force planning and the recruitment and selection of new hires.

Work force planning

Work force planning is an important process to go through if:

- Labor productivity or labor costs appear to be out of line.
- The manager is having difficulty hiring and keeping good employees.
- A major business change will affect the present work force and/or the hired and number of workers needed.
- A new business is being started that will involve family members and possibly hired workers.

The discussion focuses on nine steps or stages in work force planning. Worksheets are provided at the end of the chapter.

Step 1. Assess past and present work force situation

Before planning for the future, it is important to step back and assess the past and present work force situation. What are the strengths and weaknesses of the current situation? What are some opportunities to take advantage of, or threats to guard against? Evaluate: (1) the manager's skills as a people manager; (2) the present work environment, and (3) the current work force.

Assess the Manager's Skills

Evaluate three aspects: (1) labor productivity and costs and (2) people skills and (3) leadership style.

Labor Productivity and Costs.

First, gather information relating to labor productivity and costs. In reviewing the data, ask these questions:

- Is the work force fully employed?
- Are workers working to their full potential or are they getting bored and need a job change?
- Are labor costs in line, or should there be higher wages, an incentive plan, or more benefits?
- Are labor costs so high that the manager has to consider dropping certain enterprises, and/or substituting more machinery and equipment, which may involve terminating some of the existing work force?

Manager's people skills.

A manager must assess himself/herself as a personnel manager, and any others who have major supervisory responsibilities. Consider experience, skills and attitudes of each personnel supervisor/manager.

As difficult and imprecise as self-analysis may be, it is likely to be quite revealing. In farm businesses, managers often strive for close working relationships with employees, often need to delegate important responsibilities, and typically want employees to feel a commitment to the goals of the business. Having an employer and employee who are compatible and complementary is essential, but unlikely if left to luck in hiring.

Managers and supervisors also should evaluate themselves. Begin with the following questions:

- What are my strengths and weaknesses?
- Am I a good teacher?
- Do I have the patience to work with people who have no farm background, or little farm experience?
- Am I a good listener?
- Do I trust my employees?
- Which, if any, of my biases could get in the way of developing a good relationship with an employee? (e.g. tobacco, alcohol use, politics, sports, or breed of livestock).
- Am I a perfectionist?
- Do my current employees respect and like me?
- Do I tend to be an optimist or a pessimist?
- What is my leadership style?
- Am I an effective delegator?

Use Worksheet 4-1 to further evaluate a manager's supervisory skills.

Leadership style.

Leadership style and attitude toward delegation of responsibility will markedly affect one's ability to hire and keep good employees. For example, one must allow the time necessary to effectively manage others. One must make a transition from being a "doer" to being a *manager* of doers. Helping others do the job is an essential part of leadership. Even though a manager may be able to do a job faster and better than the employee, an effective manager will become a leader, teacher, and helper.

Employers with a small number of employees may have a particularly difficult problem with delegating because they tend to remain largely doers while doubling as personnel managers. *One who is unwilling to accept leadership and training responsibilities and to delegate should be cautious about building a business around hired employees.*

One's leadership style directly affects the work environment on the farm. It will also dictate the characteristics of employees one will be able to hire and keep. For example, a "**little general/my way**" manager, needs to hire followers or possibly someone who can stand up to an autocratic manager and do the job even better than the manager can. Considerable time is required to train followers to do things "your way". At the other extreme, is the manager with a loose or free rein style. A "**cheerleader-type**" manager needs to hire self-starters who have the ability to work with others. Hiring people with substantial experience may be necessary because a free rein style may make it difficult to allocate the time necessary for needed training. In the middle of these two extremes is the **adaptive** leader who hires the type of employee the job requires and adapts the training program and management style to the needs of individual employees. See Chapter 5 for more complete discussion of leadership styles.

Honest assessment of these three areas suggests desirable and undesirable characteristics of employees to work with and for a given manager. It may become apparent that a person who would make an outstanding employee for one farm situation may present serious problems for another.

Assess the current work environment

To attract good employees, a business must have some advantages over competitors such as:

- Competitive wages.
- A flexible work schedule.
- Opportunity for training.
- Some type of incentive program.

Is there a good work environment:

- Good people to work with
- Good equipment in safe working condition.
- A good image as a place to work?

What potential does the job hold for an employee?

- Future role in the business?
- Chance for growth?
- Added responsibility?

Other questions to ask and answer include: Who is the boss? Who reports to whom? What can each employee decide on his or her own? How have family members on the management team divided responsibility? Do employees think they are supervised or do they believe that everyone works together to get the job done? These questions all deal with organizational structure. The biblical precept that a man cannot serve two masters still holds true. In fact, it is a major reason employees leave. If employees are expected to serve two masters, these so-called masters need to be exceptionally well coordinated and organized themselves.

Organizational structure must be dealt with, particularly in multi-management situations. Myths about organizational structure are rampant. Some examples:

- Only farms with many employees have organizational problems.
- Everyone knows who the boss is.
- Organizational structure is important only in dealing with big problems.
- We all work together so organization is unimportant.
- Having only family members involved in the farm eliminates organizational problems.

No two farms should be organized alike. Personnel managers, employees, families, and the work involved vary from farm to farm, so the organizational structure needs to vary. Keys to effective organizing include:

- Proper planning of the organization.
- Clear relationships among the people in the organization.
- Delegation of authority.
- Clear limits to the delegation.
- Authority accompanied with responsibility.
- Neither over- nor under-organization.

These topics are discussed in more detail in Chapter 5.

The likely present and future **local employment situation** should also be taken into account as work force plans are developed. If certain types of labor are very scarce in the local area, then other options will need to be considered to meet work force needs. Some of these options will be discussed in the next segment.

Assess the current work force

Next, assess present workers' abilities and needs. First, list the people currently involved in the farm enterprise. This includes the manager(s), family members, hired workers, independent contractors, consultants and others. Make note of workers who may leave or are added to the work force (e.g. family members).

Then make an assessment of each individual, using Worksheet 4-2. This would be a good time to sit down with each person to review their situation and the plans for the business. Also, explore their interests in fitting into these plans. Workers will normally accept change better if they are part of the planning process.

Summary: Strengths and weaknesses? Opportunities and threats? Implications?

Using Worksheet 4-3, summarize the findings. What are some strengths and weaknesses, and opportunities and threats associated with the current work force situation. The manager should also consider the implications of these findings for future plans.

Steps 2 and 3. Project work force needs; Match with current workers

Using a form such as Worksheet 4-4, project the hours of labor involved in producing the products the farm plan calls for, along with hours involved in marketing these products, in maintaining equipment and facilities and managing the overall business.

Since many farm enterprises require varying hours of work during the year, break the total hours into hours required by periods. Adjust the periods at the top of the column to fit the situation. Also, list the tasks involved for each activity in the right hand column.

Next, match projected needs with the current work force. Five adjustment alternatives to be considered in this matching process include:

Alternative 1. Worker continues in present job (least change, stress).
Alternative 2. Job changed to fit worker's skills and interests (alleviates boredom/provides further employee development).
Alternative 3. Shift worker to new job (watch learning curve/training needs/ stress).
Alternative 4. Adjust both worker and job (see concerns noted in alternatives 2 and 3).
Alternative 5. If justified, dismiss the worker. Possible reasons for dismissal include past performance, worker's abilities versus needs or job elimination.

Which of the five options should be used? This needs to be decided on an employee by employee basis. Normally, this involves a discussion between manager and employee, so that the employee's needs and desires are considered as well as those of the business. Keep some flexibility though as the job market may dictate the type of worker that can be hired.

Steps 4 and 5. Determine remaining work force needs; explore options

First, determine remaining work force needs by comparing projected needs (Step 2) with the work force needs that will be met by the current work force (Step 3). If there is a close fit, then the manager may decide to hire part-time workers or independent contractors to meet remaining needs. Job descriptions should be developed for current workers.

If, however, there is major work yet to be done, then the manager needs to consider possible options for meeting these needs. Some options might include:

- Hiring others to do the job, e.g. hiring an independent contractor or custom hiring selected field operations.

- Substituting capital for labor. Here, the manager should review the situation in terms of whether the use of better machinery or equipment and possibly more labor-efficient facilities would help meet needs. This option should be evaluated carefully so the cost of production is not increased substantially just to avoid hired work force problems. Another possibility might be to exchange labor and machinery with a neighbor.

- Changing size and mix of enterprises and systems. How would a change in the size and kind of enterprises impact the work force situation and needs? Would a change in production systems reduce work force needs? This option may be viewed as a "last resort" option. If other options, including the hiring of additional labor, fail to meet work force needs, then adjustment in the overall business plan may be needed.

- Hiring additional labor: full-time, part-time, interns and/or apprentices.

Steps 6 and 7. Decide on plan of action; develop tentative job descriptions

Once various options for meeting work force needs have been analyzed, the manager must decide on a plan of action. If this plan calls for the hiring of additional labor, the manager should develop tentative job descriptions for the current work force and for the potential new hires, Worksheet 4-5. These job descriptions should be considered tentative as the current labor market and the workers available will likely require some job adjustments even among current workers.

Steps 8 and 9. Develop a workable implementation plan; monitor and adjust it

The manager must next develop a workable implementation plan and put in place a plan for monitoring and adjusting the plan as needed.

Developing a workable implementation plan

There are likely to be three dimensions to this plan: (1) the current work force; (2) the recruitment and hiring of new workers; and (3) implementing other adjustments such as those described in Step 5 above.

The current work force

Planning Step 3 involved the process of matching the present work force to projected needs. Five adjustment alternatives were outlined, ranging in little or no change from the worker's present job to one where the worker is dismissed.

Between these extremes were alternatives requiring changes in the worker's job, changes in the job to fit the worker, and changes in both the worker's assigned task and the job itself. In these cases, the manager should review portions of Chapter 5. Of particular import will likely be segments dealing with job training and motivation. Lay out a plan for each worker.

Recruiting, selecting and orienting new hires

The plan of action for the work force may call for hiring new workers. With the tentative job description(s) in hand, the next step is to begin the process of recruiting and selecting new hires. Unit II of this chapter discusses this process. It is important to do the hiring process well; it will save a lot of grief later on.

Once the hiring process is completed, the manager should begin the process of orienting and integrating the new hire into the work force. This should be done on an individual worker basis. Some suggestions for this orienting process are contained in Unit II and the segment dealing with worker training in Chapter 5.

Make plans to implement other approaches to meeting work force needs

In Planning Task 5, several other approaches for meeting work force needs were discussed. If the resultant work force plan includes any of these options, the manager should lay out a plan for implementing them.

- Hiring others to do the job. This option involves the possibility of hiring independent contractors or custom operators in meeting work force needs. This would necessitate the development of contracts with the individuals or businesses involved.

- Substituting capital for labor. This option may require the re-working of the overall business plan. In any event it will involve the adaptation or purchase of equipment or facilities and the financing of the adjustment.

- Changing the size and/or mix of enterprises/system. Such an adjustment will likely require a reworking of the overall business plan. Therefore it should normally be viewed as a "last resort" for meeting work force needs.

- Possible changes in business organization. Options include: (1) establishing a joint venture with another business and (2) the exchange of work and equipment. These options will likely require some re-working of the overall business plan as well as plans for the current work force.

Monitoring and adjusting the work force plan

Now is a good time to lay out a procedure for monitoring the work force situation. Several types of records need to be kept for business analysis, for employee evaluations and for meeting reporting requirements inherent in labor laws and regulations. See Chapter 5 for ideas as to the types of labor records needed.

Periodically, the manager should review the information being gathered and decide whether adjustments should be made. This may also necessitate some refinements in the reporting system.

Staffing: Recruitment and selection

Another important task in personnel management involves recruiting and selecting new employees. Hiring the right people is often the greatest talent a manager can have. It is also generally true that if one spends more time and effort hiring the right people, then it is likely that much less time will be spent firing people or putting up with "misfits".

Thus, have in place a well thought-out recruitment, screening and interview process to achieve the best possible match of workers and jobs. Avoid the "warm body" syndrome: "I'll just hire anybody; I'll be able to change and develop them." Similarly, though it is generally possible to teach new employees necessary skills, it is very unlikely that one can change their personality to any marked degree.

Phase 1. Employee recruitment: Building a pool of applicants

Recruitment involves the process of attracting individuals on a timely basis, in sufficient numbers, with appropriate qualifications, to apply for jobs within a business. This definition implies an organized, managed process of recruitment as opposed to hiring employees on a walk-on basis.

Importance of enough time to recruit

Perhaps the most common mistake that farm managers make in recruiting potential employees is not investing the time and effort required to do the job correctly. Since intensive livestock farms, such as dairy farms, operate seven days a week and sometimes around the clock, a vacancy in one position can create substantial problems if there is no plan to replace an individual who suddenly resigns or is sick for an extended period of time.

Having contingency plans for backup labor is a critical part of personnel management. **Backup labor** gets the work done in a timely fashion and at approximately the same level of quality while a position is temporarily vacant. Unfortunately, many managers make the mistake of not having sufficient temporary or backup labor to see the business through difficult times. Though it is common for farm managers to have a 30 year-old tractor as a backup piece of equipment that will only be used two or three times a year, they generally fail to follow the same practice when it comes to employees.

The cost of not having backup workers can be high. Jobs not completely or correctly performed over the period of a day or several days can create substantial costs to the business in lowered productivity, reduced quality, and costly mistakes. By having backup labor in place, a manager also allows sufficient time for the recruitment process, and increases the chances of getting the most qualified and productive worker to fill a vacant position.

Increasing the size and quality of the applicant pool

It is common practice in larger businesses to recruit many more applicants than are actually needed to fill a position. First estimate how many initial applicants would be needed to end up with three applicants to offer the job to. As an example, assume that a dairy farm manager is attempting to fill a middle management position by running a series of newspaper and magazine advertisements to recruit applicants. The ads generated resumes and applications from fifty applicants. Twenty of these applicants were judged to be potentially qualified. These twenty were screened to the ten best. Of the ten applicants, six were willing to come for an interview. Three of the applicants were worthy of being offered the job. One of the three was willing to accept. This scenario illustrates the importance of having a sufficiently large pool of applicants from which to choose. During times of tight labor markets, the relative number of applicants and acceptances decreases as job seekers have more alternatives.

Following are seven common methods used to attract good employees and the potential value of each in improving a recruitment program.

- **Suggestions from current employees.** Current employees can be excellent sources of contacts for new employees. They know people in the community where the farm is located and they have a good idea of what the labor needs are. They also have a stake in the process since they could be working with a person they have suggested if the person is hired. This approach, while effective, should be used with care. The same criteria for hiring another applicant should be used when hiring friends or relatives of a current employee. If the new person does not work out, there could be friction between the manager and the employee who suggested the applicant. This points out the need for dealing with all employees in a businesslike fashion, as well as monitoring and evaluating employee performance.

- **Word of mouth.** This technique has been very successful for many farmers and is the most common recruitment method. Friends and neighbors can refer potential applicants. Also, there are networks of agribusiness professionals (such as seed sales representatives, veterinarians and lenders) who get around to many farms and may be in a position to inform the manager of prospective applicants.

- **Want ads.** One frequently used recruitment method is the want ad placed in newspapers or agricultural magazines. This approach has several advantages. It is quick, it is relatively inexpensive, and it provides a way to reach a potentially large worker pool. But newspapers may also have some drawbacks. Often managers complain that ads bring applicants but none they would want to hire. Perhaps the answer to this problem is the wording of the ad. To recruit the best applicants, an ad must provide valuable information to the applicant as well as sell the position. The following suggestions are designed to help write better help wanted ads.

  - If appropriate, give the job a title.
  - Describe the job.
  - Indicate qualifications, work experience desired.
  - Highlight positive working conditions.
  - If appropriate, provide information on wages and benefits.
  - Indicate how to apply.
  - If appropriate, give the deadline for application.

- **Government employment services.** Almost every state has an employment service office located in each county to provide valuable services to employers on request. A counselor will help the employer define the job and write a job announcement. The announcement is then posted in the job service office (without the name of the employer). Interested applicants go to job service personnel to request more information. Applicants are screened by job service personnel and qualified ones are referred to the employer. The state job service is often under-utilized by the agricultural community.

- **College placement offices, technical colleges, short courses.** College placement offices (both four year and two year) can be a source of very good farm employees. Graduates of these colleges seeking farm work are very much in demand. Unfortunately, there are usually more farm positions available than college graduates to fill them. Graduates of technical colleges and farm-oriented short courses can also be excellent sources.

- **Posting job announcements on bulletin boards.** While farmers typically have not written and posted formal job announcements, this is another approach which can help get the word out. If there is a written job description, writing a job announcement is fairly easy. Take the key aspects from the position description and write an announcement which can be posted on bulletin boards in the community. Job service counselors can help with this also. The job announcement should contain the same type of information as noted for a want ad.

After a suitable position announcement is prepared and duplicated, post it in areas where potential farm workers will see it. Such places might include bulletin boards at agricultural college career offices, farm credit offices, and farm supply stores. It might also pay to distribute the announcement to key agribusiness contacts; then they will have the details if they come in contact with a potential applicant.

- **Private search firms.** There are a number of private firms (sometimes known as "head hunters") that make a business of finding prospective employees for employers with vacant positions. In agriculture, most such firms are located in the Midwest and their ads can usually be found in popular farm magazines. Some farmers are just beginning to use these firms to fill key farm positions, and have found that they represent another legitimate avenue in the recruitment effort. A major consideration in deciding whether or not to use this alternative is cost. Most search firms work on a commission basis and may charge the employer 10% to 30% of the new employee's annual salary as a finders fee.

In today's job environment, aggressive marketing of a job/position is important and will likely pay off if done carefully. One thing is certain, in a competitive job market, effective recruiting requires time, effort, and patience.

Employment applications/screening applicants to be interviewed

Potential employees inquiring about a position should fill out an application for employment, such as Worksheet 4-6. A manager may also wish to provide a copy of the job description.

Once a number of applications have been received or the final application date has passed, screen the applications and come up with a list of applicants to be interviewed. Some of the tools or techniques to be used in the screening process include: (1) comparing information on the application forms, (2) telephoning or having preliminary interviews with selected applicants, and (3) checking references.

Key things to verify during the screening process are:

- Education and training.
- Past work experiences.
- Key attributes relative to the particular position, such as:
  - Personal traits/attributes.
  - Technical skills.
  - Ability to get along with others.
  - Leadership and management skills (if part of the position).

Phase 2. Interviewing selected candidates

Invite the most promising applicants to the farm for an interview. Applicants' spouses should also be invited if it seems desirable or is requested by the applicant. The purposes of the interview are to: (1) give the applicant a clearer picture of the job and what is expected, as well as working conditions and compensation, (2) allow the employer an opportunity to compare each applicant's qualifications and aptitudes, and (3) provide opportunity for current employees to become acquainted with the applicants.

It is important that the manager be well prepared for all interviews and avoid interjecting personal biases into the interview and selection process. Follow a uniform interview process, which will aid in the selection process and avoid potential lawsuits involving discrimination.

Preparing for the interview

The employment interview is the most commonly used source of information in employee selection. It is a selection tool to predict the performance of a potential employee. While it is obviously difficult to make such predictions with absolute certainty, a systematic approach to interviewing can make a big difference in the hiring decisions.

Many people find conducting an interview to be the most difficult step in hiring a new employee. Therefore, some advanced preparation for an interview is well worth the effort. An interview can help one "tune in" on the personal traits of a prospective employee and confirm or challenge any information the person has previously provided. After all the interviews have been completed, there comes the task of organizing and reviewing a great deal of information to compare all the candidates. The more systematic a manager can be in the interview procedures, the easier the task of selecting the most suitable candidate for the job will be.

Develop an employee interview form, such as Worksheet 4-7. The form needs to fit the interviewer and the particular situation. Key items in the employee interview process are likely to be: (1) assessing the applicant's farm work experience and skills, (2) discerning the applicant's reasons for leaving a previous job, and (3) determining the applicant's goals and aspirations relative to farming and their reasons for applying for this position.

The form contains a proposed list of characteristics to look for in an employee. Adapt this list as needed and rate each individual on each item. *Appraise the personal characteristics of candidates carefully*. Employee values and attributes are usually more important and harder to change than present work skills and knowledge. Look for such traits as a positive attitude, willingness to work, persistence, maturity, ability to get along with others, good judgment and honesty.

Guarding against personal biases

The interview is a critical part of the selection process. But, be aware that although the interview is widely used in employee selection, it can have limitations as a predictor of performance. In other words, the wrong person can get selected for the job. One reason for this is the interviewer's personal biases. The challenge is to recognize in oneself the opportunity for error and resist it as much as possible. The most common biases include:

- **Stereotyping.** This is the tendency to attribute certain characteristics to particular groups of people. For example, one may believe that women, in general, do a better job caring for calves than men do. This could bias one's thinking and prevent selecting a male applicant who might be better than the female applicants available.

- **Halo effect.** This is the tendency to regard highly an individual who has a characteristic the interviewer particularly likes, while disregarding some of the interviewee's other qualities which may be as important but less impressive.

- **First impressions.** First impressions of an applicant often interfere with a manager's assessment of an applicant as the interview progresses. In other words, clinging to a premature judgment made in the first two or three minutes of an interview can bias the remainder of the interview.

- **Projections.** It is common to attribute one's own motives to others. For example, if a manager finds money is a major motivator, he/she might assume that others possess the same motivator.

- **Contrast.** This is the tendency to evaluate an interviewee by those with whom one has just had contact. For example, after just interviewing a poor applicant, an ordinary applicant may look great by comparison.

Conducting a successful interview

Before the interview process begins, it is important to have a plan and to keep in mind several important aspects of interviewing. Remember that certain questions are illegal and cannot be asked. In general, do not ask about race, religion, age, or marital status. Employers may ask whether an applicant has any disability that would interfere with job performance.

The following suggestions can contribute to a more successful job interview:

- **Put the applicant at ease.** Chances are applicants will be a bit nervous. It is important to make them feel as comfortable as possible. The more the manager can do to alleviate tension, the more meaningful will be the communication. A handshake and friendly smile are a good start. Finding a quiet, comfortable place where the interview will be conducted without interruption is a must.

- **Provide candidates with a clear picture of the position and what is expected.** Present the job opportunity positively, *but do not oversell it*. Describe in some detail the business and its long-term goals. Outline duties and responsibilities of the job and of the manager. Show prospective employees around, introduce them to other employees, and be willing to spend some time with them. Although it is not legal to ask about an applicant's marital status, if the applicant mentions his/her family, be mindful of the applicant's family and what the job offers them. Try to determine if the family will be satisfied with what is being offered and how supportive the family is of the applicant's interest in farm employment.

- **Check information on the application form with candidate.** Go over the information on the applicant's application form to double check and to ask for clarification or for additional information if needed.

- **Ask each candidate general questions such as those listed on interview form.** Ask applicants to talk about themselves and past job-related experiences. Be ready with some open-ended questions:

  –If appropriate, give the job a title.
  –What are your strengths and weaknesses?
  –What do you like or dislike about farm work?
  –What are your most and least favorite things to do on a farm?
  –What do you hope to be doing five years from now?
  –How do you approach work/tasks that you don't particularly like to do?

- **Provide opportunity for current employees and/or family members to become acquainted with applicants.** Having other members of the family and one or two current employees interview the applicants can provide helpful observations and impressions different from, or in addition to, the manager's. If there are substantial differences of opinion among the interviewers, it may be necessary to invite one or more of the applicants back for a second interview.

- **Comments relative to wages and benefits.** If wages and benefits are mentioned be sure to do so near the end of the interview. Providing this information early in the interview may cause the applicant to gain or lose interest in the position on the basis of compensation alone.

Closing the interview

When closing an interview, make no commitments. Assure the applicant that if he or she receives an offer, there will be ample opportunity for discussion of detailed questions about the job and conditions of employment. Give the applicant a date by which a decision is to be made. Be sure to call or write by that date and report the results: Yes, no, on hold, or still interviewing.

Ending the interview on a positive note is very important. Even though the applicant may not be offered the job or may not accept an offer, he/she might recommend someone else for the position. Applicants are likely to discuss the interview, the manager, the business, and the position with friends and families. In those conversations, it is an advantage to have each applicant be enthusiastic and positive.

Testing skills/checking references

While skills tests are not used in most farm situations, perhaps they should be employed more often as a measure of an applicant's ability. Hiring an employee on a probationary basis may be practical in the farm setting, providing the candidate will accept the job on those terms.

Business people responsible for hiring hundreds of employees each year, put high priority on reference checks in conjunction with the interview process. Checking references on a consistent basis is an important hiring practice. While references can be checked at any time, it is usually more practical to narrow down the top candidates for the job before starting to check references. Otherwise, it may be too time consuming.

Following are examples of some questions to ask a previous employer:

- How long did you employ the individual?
- What was the person's quality of work?
- How much responsibility was the worker given?
- How did the individual get along with fellow workers, agribusiness reps, etc.?
- Was it necessary to provide close supervision?
- Why did this worker leave your farm?

Consider using a rating scale from 1-5.

Phase 3. Selecting employee to be hired: Informing other candidates

Through the process of selecting a new employee, keep in mind that the person may not be the most qualified, the most experienced, or the one willing to take the position at the lowest wage. However, a manager must feel comfortable with any applicant that will be offered a job. Most important is an enthusiasm about the person chosen and a conviction that the working relationship will be positive.

Select the candidate who best fits the job description. Changing the job description to fit the person is a common temptation. To illustrate, "I was looking for a mechanic, but since you are such a nice person, I am going to hire you. Even though you don't like machinery and have no experience as a mechanic, I think you will fit in well here." The planning process emphasizes recruitment based on the *needs* of the business. Changing a job description may be throwing away the benefits of planning. Also, do not hire an overqualified or under-qualified employee. If that happens, either the employer or the employee is apt to be dissatisfied. Also, remember that a potential employee can be trained, but it is next to impossible to change an *employee's personality*. New employees and their personalities must fit well into the existing labor/management team.

Once a candidate is chosen to be hired, inform them and ask whether they are interested and would likely accept the position. If so, schedule a final meeting to fine tune the position description and the wage and benefit package. For full-time, regular employees, a written employment agreement should be developed and signed by the parties involved; see Worksheet 4-8. This agreement should include wages to be paid and benefits to be provided. Use Worksheets 4-8 and 4-9 as guides in developing an agreement. The job description should also be reviewed, adjusted, and made part of the employment package.

Inform other applicants of the decision and reasons for the choice made. Remember, a decision can be challenged if legally proper procedures aren't followed.

Phase 4. New employee orientation

Once the hiring process is completed, provide orientation for new employee(s). This program might include:

- Welcoming the new employee.
- Reviewing the work responsibility of the new employee and goals for the position.
- Providing an overview of the business operation and where the new employee fits.
- Introducing the new employee to other employees, particularly those with whom they will work.
- Restating policies, procedures, philosophy and goals.

Provide the new worker with an employee handbook, if there is one. See Chapter 5 for more details on integrating new workers into the business.

Special note: This orientation process doesn't have to be done in one day or in one session. It is usually best to start with things the employee absolutely needs to know the first day on the job. The rest can be spread out over a period of weeks or even months.

Worksheet 4-1. Self-evaluating supervisory skills.

	Seldom 1	2	Usually 3	4	Always 5
1. I treat employees with dignity and understanding					
2. I recognize employees as an important part of the farm operation.					
3. I make the rules clear and concise.					
4. I "request" rather than "order" a job done.					
5. I encourage ideas and suggestions.					
6. I help employees take responsibilities.					
7. I continually train employees where needed so they can do a better job.					
8. I praise employees for a job well done.					
9. I use positive criticism. I show employees how they can improve.					
10. I encourage employees to participate in social gatherings for employees, and in community activities.					
Total number of checks					
Times scale at top of column					

Total Score

Match your total score against the scorecard below.

Point score	Comments
15 to 20	Better get started! You've got a long way to go.
20 to 30	You're moving, but there's still plenty of room for improvement.
30 to 40	You're coming on strong - keep up the effort.
40 to 50	I'll bet your employees like working for you!

Worksheet 4-2. Assessing your current hired worker's abilities and needs.

1. What is the person's background-experience and education? ______

______

______

______

2 What particular abilities does this person have? ______

______

______

______

3. What are this person's strengths and weaknesses? ______

______

______

______

4. What are this person's interests? What motivates him/her? ______

______

______

______

5. What are the person's own personal goals is life? ______

______

______

______

6. Conclusion: Where might this person best fit in meeting your work force needs? ______

______

______

______

Worksheet 4-3. Overall assessment of current work force situation.

Strengths

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________
6 ______________________________

Oportunities

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________
6 ______________________________

Weaknesses

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________
6 ______________________________

Threats

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________
6 ______________________________

Worksheet 4-4. Estimating your workforce needs/skills required.

Activity	Distribution of hours					Tasks involved and skills required
To produce:	Total hours	Dec-Mar	Apr-June	July-Aug	Sept-Nov	
Total labor-production						
To market products						
To maintain equipment						
Overhead/Managing						
Total Labor						

Worksheet 4-5. Example job description form.

I. General

Business/farm name ______________________________

Address ______________________________

______________________________ Phone (____) ______________

Position title ______________________________

Summary description of position ______________________________

____

II. Major duties, responsibilities, and authority:

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________

III. Minor/other duties:

1. ______________________________
2. ______________________________

IV. Supervision provided:

A. Amount: None ______ Minimal ______ Considerable ______ Close ______

B. Manager/supervisor: ______________________________

V. Normal work hours/overtime: ______________________________

____

____

VI. Work environment: ______________________________

____

____

VII. Advancement/promotion possibilities: ______________________________

____

____

VIII. Qualifications required/desired:

	Required	**Desired**
1. Formal education/ training:		
2. Work experience:		
3. Skills/knowledge:		
4. Personal characteristics:		

Worksheet 4-5 (continued). Example job description form.

5. Physical attributes: ____________________ ____________________

6. Flexibility (time, task): ____________________ ____________________

7. Other: ____________________ ____________________

IX. Wage rate:

Beginning $__________ Per __________; Range __________

Bonus, incentive programs (if any): ____________________

X. Benefits provided/housing

____

XI. Provisions for time off/vacation/sick leave:

____

Worksheet 4-6. Example application for employment form.

____________________ Date __________
farm/business

1. Personal information

Name ____________________

Address ____________________

____________________ Phone (____) ________

*Spouse's name (if any) __________ *Children/Ages (if any) __________

(Optional - Applicant is not required to provide this information.)*

2. Work experience (Beginning with most recent employment):

Employer #1 ____________________

Address ____________________

____________________ Phone (____) ________

Job duties ____________________

Dates worked __________ Wage or salary received __________

Reason for leaving ____________________

____

Employer #2 ____________________

Address ____________________

____________________ Phone (____) ________

Job duties ____________________

Dates worked __________ Wage or salary received __________

Reason for leaving ____________________

____

3. Why are you applying for this position? ____________________

____

4. Do you have any health problems or physical impairments which would interfere with your doing strenuous physical work? If yes, please explain. ____________________

____

5. Education/Training ____________________

____

5. Rate yourself relative to the following characteristics and add any comments that you think would provide a complete picture of your skills, experience and abilities.

	Low		Avg		High
	1	2	3	4	5
a. Training and work experience					
Livestock production					
Crop production					
Mechanical skills/operation					
Marketing skills					
Budgeting/financial skills					
Other skills: __________					
Comments: __________					
__________					

Worksheet 4-6 (continued). Example application for employment form.

	Low 1	2	Avg 3	4	High 5
b. Personal traits/ characteristics					
Ambitious/work hard					
Self Starter					
Honest/trustworthy					
Work well alone					
Other: ______					
Comments: ______					
c. Working with/for others					
Ability to work with others					
Ability to compromise					
Receptiveness to receiving directions					
Ability to understand directions					
Willingness to ask questions					
Other: ______					
Comments: ______					
d. Leadership/management					
Leadership ability					
Ability to manage others					
Ability to make decisions					
Other: ______					
Comments: ______					

6. List of references

Name ______ Address ______ Phone (___) ______

______

Name ______ Address ______ Phone (___) ______

______

Name ______ Address ______ Phone (___) ______

______

Signed: ______ Date: ______

Worksheet 4-7. Example employee interview form.

Date ____________________

Primary interviewer ____________________

Other interviewers ____________________

1. Name of applicant ____________________

Address ____________________ Phone (____) ____________

____

2. Provide candidate with clear picture of position and what is expected of him/her.

a. Provide candidate with position description/review it.

- Comments/questions:

b. Provide candidate with overview:

- Business philosophy and policies.
- General nature of business/business goals.
- Where candidate/position fits in the business.
- Working conditions.
- Opportunity for growth/development.

3. Check information on application form with candidate.

a. Health situation (optional) ____________________

____

b. Education and training ____________________

____

c. Exact nature of work experiences ____________________

____

d. Reasons for applying for this position ____________________

____

e. Candidate's rating of self (relative to this position)

- Training and experience ____________________

  ____

- Personal attributes ____________________

  ____

- Ability to work with/for others ____________________

  ____

- Leadership/management ability ____________________

  ____

f. What kinds of jobs/tasks:

- Do you like to do on a farm? ____________________

  ____

- Don't like to do? ____________________

  ____

- How do you approach jobs that are required even if you don't like doing them? ____________________

  ____

4. Some general questions of candidate:

a. What are some of your strengths? Past Accomplishments? ____________________

____

____

Worksheet 4-7 (continued). Example employee interview form.

b. What are some of your weaknesses? Have you ever failed at something? How did you respond?

c. What do you feel you can do for our business?

d. What type of manager do you like to work for?

e. What are your goals and aspirations relative to a career in farming?

f. In a few words, describe the type of person/worker you are:

5. Comments, if any, about applicant's spouse and family (optional)

6. Agreed upon follow-up

7. Evaluations by current employees/family members

8. Key comments from references

9. Overall rating

10. Other comments (by interviewer)

Worksheet 4-8. Example employment agreement form.

Farm Employer-Employee Agreement of Employment

I, ______________________ (employer), agree to employ ______________________ (employee) to work on my farm located: ______________________ beginning (date) ______________________ and continuing until such time as either wishes to terminate this agreement by ____________ days written notice.

The employee will be terminated immediately for prosecutable offenses against the business or community and for actions such as stealing or drinking on the job.

The employer, and the employee, agree to comply with the following conditions and actions:

1. Duties and Responsibilities/Supervision

______________________ (employee) duties and responsibilities are detailed in the attached position description. His/her supervisor will be ______________________.

2. Work Hours/Overtime

The normal daily working hours are from ________ to ________, with one hour off for breakfast and one hour for lunch plus a 15 minute mid-morning and mid-afternoon break. Overtime will be paid for any work done before ________ and after ________ at the rate of 1½ times the normal wage rate. Overtime will also be paid after _______ hours are worked in any week, Sunday through Saturday.

3. Time-Off/Vacations

Employee will have ________ days off per month. The employee will have the following holidays off ______________________ and will be notified ________ days in advance what the arrangements will be. The employee is entitled to ________ weeks vacation with pay annually which will be taken during the non-critical work season and agreed upon by both parties ________ days prior to beginning vacation. The employee is entitled to ________ days of sick leave with pay annually for time off due to actual illness.

4. Wages and Benefits

- Employee will be paid $__________ per __________ from which the employee's income tax and social security taxes will be withheld. Wages will be paid on __________ (day) of (week/bi-weekly/monthly).
- The following bonus or incentive plan is included (if any) (see attached form): ______________________
- The following housing arrangements are provided, if any: ______________________
- The following insurance plans will be carried on the employee, if any: ______________________
- The employee is entitled to the following farm produce, if any: ______________________

5. Other provisions as agreed upon:

____

____

______________________ Date signed ______________
Employer's signature

______________________ Date signed ______________
Employee's signature

Worksheet 4-9. Wages, incentives, and benefits agreement form.

Employee ____________________ Date ____________

Employee's responsibilities	Example		Actual plan	
	John Smith, age 21, hired as semiskilled worker			
	Cash received per year	Value other benefits per year	Cash received per year	Value other benefits per year
Cash wages	$850/mo.	$10,200		
Bonus/incentive payments				
Crop				
Livestock				
Other/bonus	200			
Fringe benefits				
Housing, room and board	---	$2,400	---	
Utilities	---		---	
Meat, milk and other produce	---		---	
Other (car, gasoline, etc.) specify	---	240	---	
Insurance (health, accident and life)	---		---	
Social security paid by employer (7.65%)	---	780	---	
Workman's compensation paid by employer (14.39%)	---	$1,875	---	
Total cash/benefits received	**$10,400**	**$5,295**		
Grand total	**$15,695**			

Managing a work force effectively

5

- Managing a work force effectively: Situation and challenges
- Management responsibility #1. Developing commitment by delegating responsibility
- Management responsibility #2. Developing ability to do the job
- Management responsibility #3. Motivating employees; enhancing their drive to achieve
- Management responsibility #4. Counseling/corrective action; Discipline/dismissal
- Application: Carrying out these management functions in three different settings
- Labor laws and regulations; records needed to comply

Managing a work force requires making and communicating decisions in such a way that employees have opportunity to perform up to their abilities and at the same time contribute to achieving overall business goals. This is not an easy task since each individual employee is different. It is also important to remember the saying: "You didn't buy your worker's body and soul; you just rented their behavior."

This chapter first provides an overview of the situation and challenges surrounding effective work force management. Then it discusses in some detail four key areas of responsibility a manager must assume. The chapter closes with a brief discussion of labor laws and regulations that may apply to a farm work force.

Managing a work force effectively: Situation and challenges

Because personnel management is increasing in importance as an area of farm management, this segment reviews the situation and challenges surrounding it.

Managing a work force effectively: The current situation

The U.S. farming industry is moving rapidly toward fewer, but much larger, multi-operator farms. It is estimated that about 75,000 farms produce about 50% of the total gross farm income, while 300,000 produce 75% of the total gross farm income. Many of these businesses require management of family and/or non-family hired workers. With rapidly changing technology, the jobs involving farm workers will require more skills, while at the same time, fewer workers will have a farm background, and/or the necessary training to do the job effectively.

Figure 5-1. Managing farm personnel: a complex, interactive process.

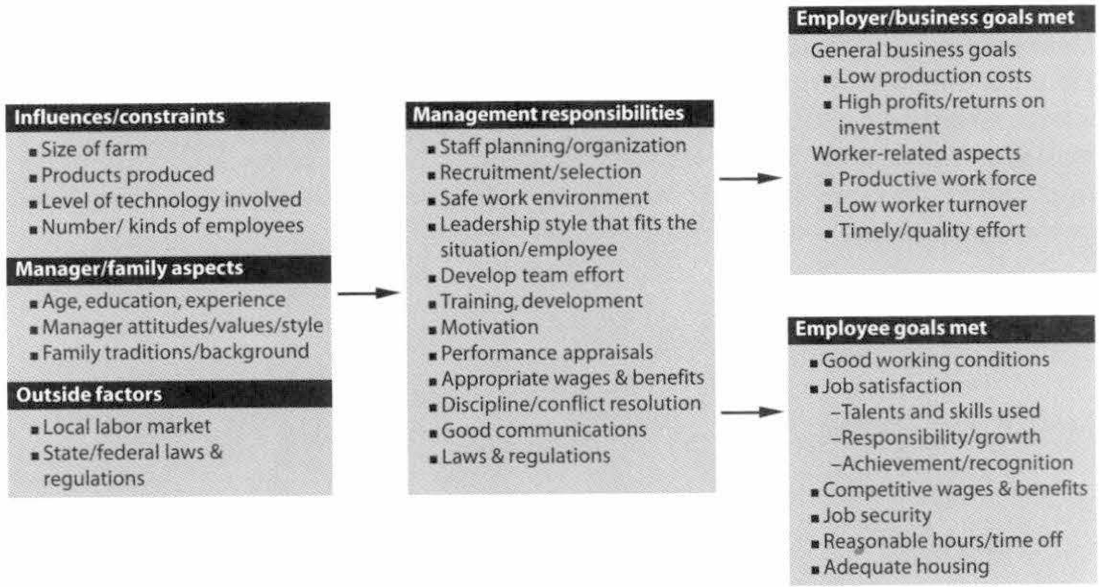


Figure 5-1 describes the complexity and interactive nature of work force management.

As indicated in the center section of Figure 5-1, there are more than a dozen specific managerial responsibilities relating to employees or family members involved in the business. Responsibilities range from planning for, hiring and firing people, to keeping up with laws and regulations relating to farm personnel.

Though all personnel managers face these responsibilities, the complexity of the task varies with the nature of the influences and constraints relating to the particular situation (Figure 5-1, left). A manager's goals, as well as the goals of each employee, also impact the personnel manager's task (Figure 5-1, right).

The current work force management situation in farming is generally not good. Many farm managers are not good managers of workers. Often they have not had the training or experience to manage workers effectively. Too often they view workers as "just another tool" to get the job done. And they often have unrealistic expectations of what a worker can or will do. This is particularly true of the manager of a small work force—a common occurrence in Midwest agriculture. Such a manager/owner is often a doer rather than a manager of doers. This often results in frustration, with the manager feeling it would be a lot simpler "to just do the job myself". The manager/owner often expects a hired worker to work just as long and hard as he/she does. As a result, farm operators often find themselves in a "revolving door" situation relative to hiring and keeping hired workers.

Managing a work force effectively: The challenges

A recent study[1] identified the major reasons employees give when they quit their farm-related job.

(1) 13.8% left because of problems with the boss or family members.
(2) 12.9% left because of a lack of achievement.
(3) 12.8% left because of a lack of responsibility.
(4) 9.9% left because of a lack of recognition.
(5) 7.9% left because of a lack of training.
(6) 6.9% left because of limited time off.

These six categories account for about 80% of the reasons given by employees for leaving their jobs. Take special note that all of these categories represent areas that the manager controls. Thus, the challenge for a manager or supervisor is twofold, to: (1) provide a well-organized, safe, team-oriented work environment, and (2) help

1. Survey by Gary Maas, Agri-Careers, Masenna, Iowa, undated.

employees develop their full potential as individuals for a satisfying work experience.

Challenge 1. Providing a desirable work environment; meeting employees basic needs

Providing employees with a well-organized, safe, team-oriented work environment is absolutely essential to effective personnel management. Each of these aspects is discussed in some detail. Some thoughts on meeting an individual employee's basic needs of security, acceptance and status in this work environment are also offered.

Providing a well-organized work environment

Planning the work a day or week in advance leads to more efficient use of labor. As the number of employees and tasks increases, this planning and scheduling function increases in importance. Here is another reason that the manager needs to become less of a doer, and instead focus time and energy to ensure that employees are able to do assigned tasks efficiently and in a timely fashion.

Effective work planning involves not only identifying the best timing and sequence of tasks, but also providing the machinery, equipment and supplies needed to accomplish the tasks on schedule. A task list identifies what needs to be done within a period of time; a work schedule identifies the employees and machines to do them. Each task listed should include a deadline and priority. Instructions should be given so that employees know what is expected of them as well as their authority and responsibility concerning the task. Continuous updating of schedules and instructions is necessary because of weather, machinery breakdowns, and unexpected employees days off.

Like other resources, labor needs to be used efficiently. Therefore, a manager needs to continually look for ways to improve employee productivity. One way to do this is to do a better job of carrying out the labor management functions discussed later in this segment. In addition:

- keep good records of time and labor use.
- look for ways to simplify approaches to various tasks.
- consider substituting additional capital for labor.

Another key to keeping things organized is making it clear who is in charge. Once authority is delegated to someone, don't go around them even though the situation seems to warrant intervention. This is particularly important in multi-operator farm units involving two or more managers from the same family.

There are several organizational structures that could be used. These include:

- Highly centralized, where all decisions are made at the top.
- Highly decentralized; where decisions are made at the lowest level possible.
- Mixed or transitional, which involves a part centralized and part decentralized.

The type of organizational structure employed should be a function of:

- The size and type of business involved.
- The availability and ability of middle management and workers.
- The overall management philosophy.

Regardless of the organizational structure, it should be communicated to all concerned. If changes are made in the organizational structure later, these changes should be communicated as well.

Providing a safe work environment

Farming is among the most injury-prone occupations. Equipment, chemicals, livestock, and often a worker's lack of farm experience, all contribute to the potential for injury. Thus, it is important that well maintained, safe equipment and facilities are provided. In general, well trained workers are safer workers. Also, keep workers informed regarding potential work hazards such as machine operation, various physical hazards around the place, and the handling of chemicals and livestock.

Also provide appropriate protection for workers and business. This would include workers compensation insurance and possibly health and life insurance. Carry liability insurance on the business since anything can happen these days. Some of these happenings could end up costing the business itself and the livelihood it provides. See the segment on Labor Laws and Regulations.

Developing a team-oriented work environment

In athletics, a group of players does not automatically play as a team. Likewise a group of employees does not automatically work as a team. Groups develop into teams when the common purpose is understood by all of its members. Within effective teams, each member plays an assigned role, using his/her talents to best advantage. When group members integrate their skills to accentuate strengths and minimize weaknesses, team objectives are usually achieved. When, on the other hand, groups work or play as individuals, they usually fail.

Unfortunately, many leaders/business managers fail to recognize and apply the same principles as they would in coaching a sport. In a work organization, they often do not understand how to transform their group of employees into a productive team.

Robert Maddux[2] lists a series of steps a manager must take to develop a team effort. A manager must:

- Select qualified people who are team-oriented and fit present team needs.
- Be willing to delegate authority and responsibility, or else be a participative or a quarterback-type manager.
- Involve team members in setting goals or standards.
- Provide conditions that support effective problem solving by team members. This may involve the manager's participation or provision for team training in problem solving.
- Provide for open communications among team members and between the team and their manager/supervisor. This may involve team training in communications.
- Provide training in, or be involved in, conflict resolution. Conflict is inevitable; plan how to resolve it.
- Help workers become comfortable in a team setting that involves developing trust of their leaders and each other.
- Provide performance feedback and proper recognition for outstanding team and individual contributions.
- Provide team members with the opportunity to test and develop their abilities involving several aspects of their teams efforts. This builds "bench strength" and individual skills for future employability or advancement.

As a manager reflects upon the team approach and its possible role in his/her business, three basic questions need to be answered:

- What could team building do for my situation? (What are some possible payoffs?)
- What is my attitude toward worker involvement and the leadership demands of team building?
- My conclusion: What are the chances of a team effort approach succeeding in my business?

Meeting the individual employee's basic needs in this setting

Employees have three major basic needs that must be met regardless of whether there is a move toward team building or employees remain a loosely defined group of people. If these basic needs are not met an employee is likely to leave. These needs include:

- **Security.** In addition to meeting the physical security needs by providing a safe work environment, an employee also has certain psychological and economic security needs. These are often tied to feeling secure in the job (the job will be there) and that the benefit package includes provision for disability and health care insurance.
- **Acceptance.** Most employees need to feel accepted by their employer and fellow workers. Each needs to feel valued as a worthwhile individual and enjoy a sense of belonging. A manager can enhance this acceptance process for new employees by

2. Robert B. Maddux, *Team Building: An Exercise In Leadership*, Crisp Publications, Inc., 1988.

involving present employees in the planning and hiring process. If a new employee doesn't feel a certain degree of acceptance within a reasonable period of time, he/she will often leave.

- **Esteem/status.** Each employee needs to feel that what they are doing is important, has value and is worthwhile to themselves, to their employer, and to their peers. Their peers may include both their fellow workers as well as off-the-job friends. Being referred to as "the hired man" can be very demeaning in today's title happy, job status-oriented society.

Challenge 2. Helping each employee have a productive, satisfying work experience

One of the most important tasks as a manager of people is that of helping each employee have a productive, satisfying work experience. There are three key elements involved:

1. An ability to adapt management or leadership style to the business/people situation.
2. An ability to view each worker as a unique and valuable individual.
3. Recognizing that an employer/employee "contract" is truly a two-way street.

Developing a flexible management/ leadership style

Many managers have a tendency to use the same leadership style regardless of the situation and/or people involved. But leadership experts generally recommend situational leadership as the best approach. This approach is based on the notion that no one leadership style is best in all cases and with all people. **Situational leadership** calls for the use of a mix of leadership styles that fit the situation and people. For example, in a crisis situation a manager may need to exert an autocratic, "my way" leadership style. On other occasions, leading with a free-rein may be best. But, it is important to be as consistent as possible when using the situational style of leadership. That means using the same leadership style in similar situations and/or with similar-type people.

There are two broad categories of manager/leadership styles, Figure 5-2. One general leadership style is task oriented: It emphasizes getting the job done. Managers with this leadership style are masters of tactics. Variations on this style include:

- **Little general:** My Way! Now! This type of manager comes in various "flavors" from the very coercive manager who expects immediate compliance with little or no worker input, to that of the firm, but fair, "boss"-type who may permit some worker input but there is no doubt as to who is in charge and calling the shots.

- **Wheeler/dealer.** A manipulator who makes various deals and promises with workers to get the present job done. The problem with this leadership style is that the leader is not always able to make good on promises, or may run out of deals to get the work done. As a result, workers end up feeling manipulated and eventually become dissatisfied or unproductive.

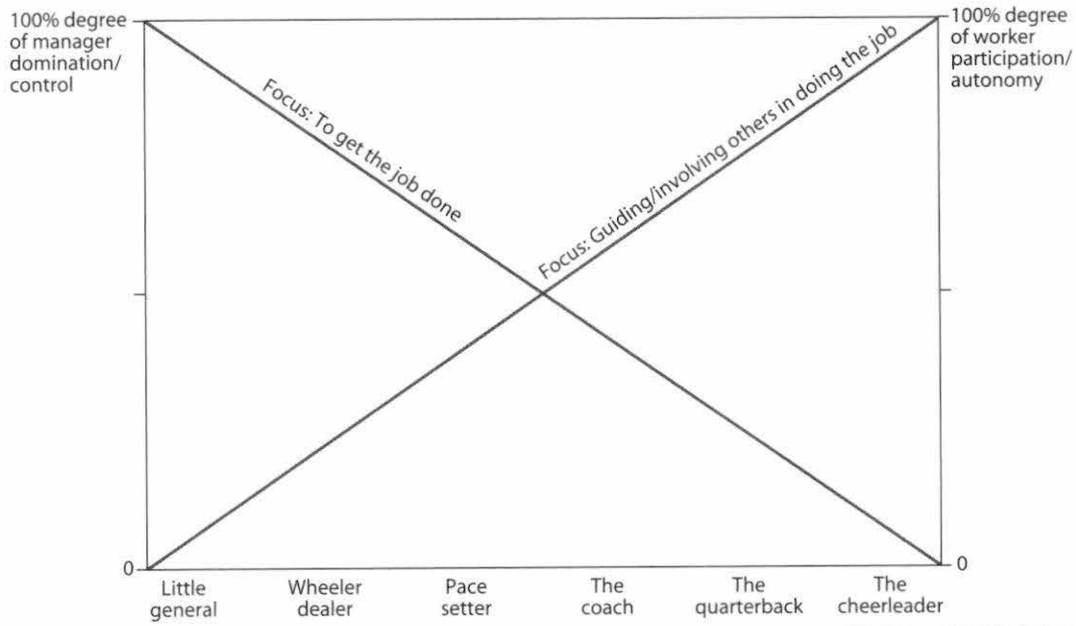
- **Pace setter.** Likes to get involved in doing the work as well as managing. Pacesetters have high standards and expect that of others. They have little concern for interpersonal relations and may reassign work if an employee's ability or willingness to perform hampers overall performance.

The second general leadership style is represented by the manager who guides and involves workers in deciding what to do and how to do it—as well as in doing it.

- **Coach.** Managers see themselves as developing their employees and are concerned about high performance. They will allow workers varying degrees of flexibility in setting performance goals, and in determining how to best address their tasks.

- **Quarterback.** These managers are known for their participative style. They tend to believe that individuals and groups function best when allowed to work together and, therefore, tend to feel that close supervision or very detailed instructions are unnecessary. They tend to hold a lot of meetings, reward

Figure 5-2. Comparison of management/leadership style and degree of worker involvement.



adequate performance, and dislike disciplining employees.

- **Cheerleader.** These managers tend to feel that people come first and tasks second. To them, the manager's job is to provide a pleasant work environment, job security and benefits. They tend to provide little direction, especially feedback about negative performance.

Self-assessment:

- Which of the above leadership styles best describes my general approach to managing people?

____

____

- Do I use different styles with different employees/situations? If so, cite examples.

____

____

- Which "default" leadership style do I tend to resort to "when all else fails?"

____

____

Manager's ability to "respect" each worker as an individual

Though most employees want to be considered valuable, accepted, and contributing human beings, each employee is also a unique person. This uniqueness expresses itself in two major ways: (1) how they have been "programmed" to date, and (2) their personality.

- **Every human being is "pre-programmed" differently.** Therefore, recognize that each employee is the result of past "programming" (e.g. past work and life experiences). Accept them as they are and manage them as unique individuals. This is particularly true today as employees come from different geographic areas, as well as from nonfarm backgrounds.

Recognize also that the current manager continues this "programming". Unless the experience with the current manager and business situation is favorable and positive relative to earlier "programming", one should not expect favorable, positive responses.

- **Every employee has an unique personality.** There is probably nothing harder to change than a person's personality. The adage "you can't make a silk purse out of a sow's ear" expresses it well. Thus, if one wants certain personality traits in employees, it is usually best to hire people who already possess them.

With current employees, accept them and build on the present "structure". This will have far more impact on their performance than trying to "repair" their present personality "faults." But, with some employees, the only viable option is to terminate their employment.

Viewing the employer/employee "contract" as a two-way street

Even a manager who employs situational leadership and "knows" each employee's uniqueness, may still fail miserably. The overriding key element in all of people management is the recognition that the employer/employee contract is truly a two-way street. Figure 5-3 provides a schematic of the key elements of this employer/employee relationship.

The interrelationship or interactive nature of these basic elements can be described as follows:

- If one wants an employee to be **committed** to the business, **delegate**. This involves delegating **responsibility**, giving necessary **authority**, and setting standards against which the employee will be held **accountable.**
- If one wants employees to have the ability and knowledge to **do the job well**, develop a program designed to make this possible. This involves **training, coaching, performance feedback** and **counseling.**
- If one wants employees to have the **desire to perform well**, motivate them through **employee benefits/compensation programs**, as well as through providing opportunities for **responsibility and growth** and a feeling of **achievement and recognition.**

This approach should result in both business and employee goals being met. Remember: "Businesses succeed only when the people within the organization succeed at their individual jobs. Businesses produce nothing; people within the business produce everything, including products, services, profits and savings."[3]

Following is discussion of four areas of management responsibility contained in the employer/employee relationship.

3. Adapted from *Shirt-Sleeves Management*, by James F. Evered, AMACOM, 135 W. 5th Street, NY, NY 10020, 1981, page 14.

Figure 5-3. The employer/employee relationship.[a]

If one wants this from employee:	One must do this:	Which involves:	Which should result in:
Commitment →	Delegate →	Responsibility Authority Accountability	
Able to do job well →	Develope employee skills →	Training Coaching Performance Feedback Counselling →	Manager's and employee's goals being met
Desire to perform well →	Motivate employees →	Compensation Responsibility/growth Achievement/ recognition	

a. Adapted from *Shirt-Sleeves Management*, by James F. Evered, AMACOM, 135 W. 5th Street, NY, NY 10020, 1981, page 14.

Management responsibility #1. Developing commitment by delegating responsibility

To develop an employee's commitment to the business, delegate responsibility. Effective delegation requires that three things happen:

- Develop a **position description** that specifies the **activities** or **responsibilities** for which each employee is responsible.
- With this delegation of responsibility should come the necessary **authority** to get the job done and done right. If a manager delegates authority but leaves too many strings attached, employees become frustrated or ineffective waiting for the manager's concurrence or rejection of a plan or decision.
- But employees must also be held **accountable.** This requires that both employer and employee agree on goals or tasks to be accomplished. It is also necessary that periodic evaluations be made and a revised set of goals be established. Employees should be made aware of the benefits that will accrue if goals are achieved or exceeded. But, employees should also know the potential consequences of failing to achieve agreed upon goals.

Management responsibility #2. Developing ability to do the job

The ever-changing, increasingly complex business of farming requires that a manager be willing to devote the time necessary to develop an employee's abilities. This involves training and coaching, timely and effective feedback, and a willingness to counsel with employees.

Training and coaching—A continuous process

New personnel, new tasks, changes in the way specific tasks are done, and changes in the responsibilities of experienced personnel, suggest a continuous need for training and coaching.

Before discussing the training/coaching process, it is well to recognize the typical learning curve of an employee, Figure 5-4. Discouragement often characterizes the first phase. The next three phases exhibit varying rates of learning. It may begin with *rapid progress*, then *plateau* for awhile, and finally the learner will reach *peak performance*. This is followed by a phase during which the job or task becomes *routine* for the worker, with little additional learning taking place. The following discussion of the training and coaching function will be built around these learning phases.

Orientation and initial training

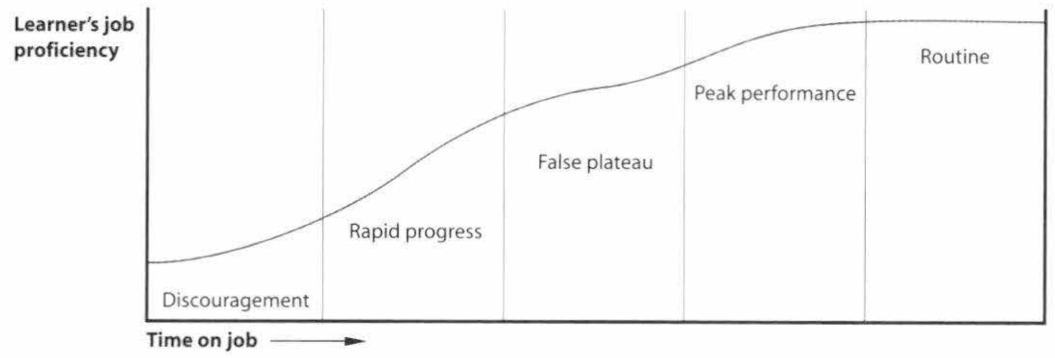
Before getting into the details of specific tasks, orient new employees to the overall business. This includes:

- Acquainting employees with the tasks to be performed.
- Providing information about how their work fits with the rest of the business activities.
- Introducing new employees to fellow employees and others involved in the farm operation.
- Explaining the rules governing such items as work hours and sick leave.

The objective of this orientation is to help new employees identify with the farm business and know they are an important part of it.

Before beginning the initial training of new employees, refer to the learning process, Figure 5-4. While each employee will progress through the learning process at a different rate, each will experience each phase to some degree. Discouragement occurs when first trying to learn the tasks contained in the new job. The learner often feels unable to master the skills. Frustration, in turn, slows the rate of learning. The duration of

Figure 5-4. Typical learning process of an employee.



this frustration depends on the learner's previous experience, learning aptitude and attitude, the complexity of the task or tasks involved, and the quality of the training program. Above all, the trainer needs to recognize that encouragement is particularly helpful as an employee goes through this initial discouragement phase of learning.

Turning to the initial training of a new employee, a step-by-step procedure is likely to increase a trainer's effectiveness.

- **Break the job into key components.** Identify tasks the employee is expected to do. Can learning some parts of the job be postponed until more important parts are mastered?

- **Prepare the employee for the training.** Preparation can include putting the employee at ease, finding out what the employee already knows, indicating why it is important to learn to do the task properly and explaining that his/her productivity, satisfaction, and safety will be influenced by the training.

- **Teach the job by describing and performing the tasks involved and answering the employee's questions.** Active involvement of the learner in this step is important. Here, one might first explain the task, then perform it, and then have the employee describe how to do the task.

- **Have the employee do the task.** Ideally, a trainer/manager should observe the employee doing the task several times before leaving the employee on his/her own. Encouragement and reinforcement help provide a sense of early accomplishment for the employee.

- **Follow-up.** Periodically check the employee's progress to ensure that the task is being done correctly and efficiently.

Coaching during the rapid progress to peak performance phases

As shown in Figure 5-4, once the employee leaves the *discouragement phase* of learning, the *rapid progress* and *false plateau* phases are likely before reaching *peak performance*. During these phases, training shifts from a focus on detail to one of coaching.

During **rapid progress** an employee typically gains confidence and becomes motivated by successes. Substantial increases in proficiency often occur. However, the trainer/coach should make sure that the tasks are being carried out properly, and that incorrect procedures are not being reinforced by the employee's new found confidence.

After rapid progress comes a **false plateau** period in which there is little change in job proficiency. Here, one may conclude that there is no need for additional training and the employee may erroneously conclude they are doing as well as possible. Additional training may have little impact. Encouragement and challenging the employee to do better will be of some help. Watch for employee complacency, which may result in an actual slippage in performance.

Peak performance is reached only after substantial practice makes various aspects of the task routine. Unneeded parts of the task are eliminated and remaining parts are integrated for maximum efficiency in time, effort and quality of output.

Good coaching will increase the speed at which employees move through the rapid progress and false plateau phases on their way to reaching peak performance.

Routinism and the next challenge

Eventually an employee reaches a point at which everything becomes routine—it's nearly automatic. Little additional gain in proficiency takes place. In fact, tasks may become so routine employee interest fades. At this point, the trainer/coach again needs to step into the picture. Tasks may need to be reorganized to provide a new learning experience for the employee. Changing an employee's responsibilities will also encourage continued growth. If such changes are to be made, orient the established employee to the new situation, provide necessary initial training as well as coaching through the various learning phases as described above.

Timely, effective performance feedback

Another important part of improving employee performance is timely, effective feedback. Some of the most effective feedback is on-going, one-on-one, and on-their-turf. To make feedback most effective requires that the employee has a job description and that performance goals have been specified. Such an approach reinforces the idea that the employees are important to the business and what they are doing is important to success. Feedback promotes understanding and, if done well, can build a level of trust that cannot be achieved any other way.

Also hold formal performance feedback sessions, i.e. job evaluations, as needed. Four things are necessary if this approach is to prove effective:

- Be prepared for the session.
- Hold it in a private setting.
- Encourage the employee's participation.
- Focus on the employee's progress in the job, not on them as a person.

Worksheet 5-1 provides a performance appraisal checklist.

Develop a guide for making appraisals. The discussion should first focus on the employee's performance relative to goals that were previously set. Both manager and employee should talk about the current situation. Then focus on the future, reaching agreement on meaningful, attainable goals for the next time period. Set a time for the next review. Formal evaluation should occur more frequently when dealing with new employees. Remember, they are going through what is often a relatively traumatic period in their lives; see Figure 5-4.

When evaluating a **problem employee**, document the situation carefully, put it in writing, and have both parties sign. It is important that sessions of this nature be handled properly and with care; see Management Responsibility #4.

Management responsibility #3. Motivating employees; enhancing their drive to achieve

If the manager has done a good job of selecting and training employees, they should be able to do an efficient, quality job. The question is, will they? Doing an effective job of motivating employees is usually necessary if this question is to be answered in the affirmative.

There are three broad approaches to motivating or enhancing an employee's drive to achieve. The first is a **"stick" approach**, which usually involves a coercive leadership style best described as "my way or else." Such an approach may work in the short-run or with a very compliant type of employee. But most often the employee will eventually "kick back" or quit when trying to work under this style of management.

The other two broad approaches are the "carrot" approach and the "soul food" approach.

The "carrot" approach to motivation

The **carrot** approach to motivation is generally considered to be better than the "stick." But the employer must make sure the carrot is reachable and worth reaching for. This means that, in addition to a reasonable base salary, achievable goals must be set and worthwhile incentive plans and bonuses be developed. These will provide the basis for matching performance levels actually achieved with goals set, and for determining additional payments due the employee.

When developing a good compensation package, keep the following ideas in mind:

- The basic wage and benefit package should reflect the competition for labor in the area and reflect the employee's job and level of performance relative to other employees with similar jobs.

- Incentive programs should be easily understood, workable and reachable, and benefit both the worker and business.

- Bonuses should reflect superior performance or achievement of a particular goal, not something that just happens every year at Christmas.

- Sufficient time off should be available so employees can enjoy the fruits of their extra effort and performance.

Worksheet 4-9 offers a model for developing a compensation package. Put these agreements in writing so that there will be no question as to the exact nature of the compensation package.

The "soul food" approach: Meeting workers' needs with on- the-job satisfaction

The "soul food" approach to motivation is being used increasingly as employees' off-the-job needs are being met by increased incomes and adequate time-off to enjoy their improved financial situation. The "soul food" approach is built around the idea that the job in and of itself can provide an incentive toward improved performance. This incentive usually involves fulfilling the employee's needs for increased responsibility and growth, as well as a feeling of achievement and proper recognition of it.

Increased responsibility and growth needs

Most workers need to feel that they are growing in knowledge and skills and that they are working up to their potential. This requires that the worker be offered opportunities for additional training and either a change in jobs or increased responsibility within their current job. The objective is to provide workers with tasks that are not so difficult as to make them discouraged or overwhelmed, yet challenging enough that the job doesn't become too routine.

Achievement and Recognition Needs

Workers also need to have a feeling of accomplishment. This means that the manager and the worker need to sit down and set goals for the worker. These goals need to be visible, attainable, challenging, and meaningful to the worker. A worker also needs to be recognized when goals are met or exceeded. A word of praise, a promotion, or a monetary reward are ways to reinforce the worker's sense of achievement.

Choosing the most effective motivational approach

Some combination of the three motivational approaches is most likely the best. The approach will vary with each worker and situation. Some need a "stick"; some will react best to the "carrot"; while still others will need numerous "strokes" to keep going and to achieve. The "soul food" approach—gaining satisfactions from the job—is becoming the preferred approach for many workers as they have been able to fulfill more of their off-the-job needs and desires via higher incomes and shorter work weeks.

Management responsibility #4. Counseling/corrective action; discipline/dismissal

From time to time a manager needs to counsel with workers. This may involve counseling sessions requested by the employee or a session requested by the manager/supervisor. On occasion discipline or even dismissal may be in order.

Counseling sessions requested by the worker

On occasion, a worker will request a meeting to talk things over. If the problem is personal- or family-related, be a good listener, and be willing to assist as appropriate. Don't try to play "doctor" or "Mr. Psyche." Employees will appreciate concern for them as persons at their time of need, and not just as someone to get work done.

On occasion, their desire to meet is job-related. In this case, first let the employee describe the nature of the concern, and let the feelings about it come out. Then, involve the worker in a dialogue; establish the management viewpoint, and then work together to find a possible solution to the situation. Once a possible solution is identified, close the session by first thanking the employee for bringing this concern forward. Then, schedule a follow-up meeting to see if things are getting straightened out.

Counseling session requested by the manager/supervisor

Situations will emerge that require that a manager or supervisor request a counseling session with a worker. This may involve relatively routine situations or more serious or chronic problems associated with the employee's work or performance.

Addressing routine problems

For routine problems, prepare for the session by defining the problem and documenting how it affects the worker's performance and other workers. Hold the session in a private setting; cover any positive aspects first, then ask the worker how things are going. Then get to the issue at hand. Tell the worker about the concerns, then listen to the worker's response or evaluation of the situation. Come to an agreement as to how to resolve the situation and schedule a follow-up session. Put written notes of the session in the worker's file. Share a copy of the notes with the worker.

More serious or chronic situations

Discipline is one of the least satisfying aspects of personnel management. Therefore, strive for self-discipline among employees. If there has been a careful recruitment of employees, followed by a sound training program, and with proper attention to human needs, the need for discipline should be minimal. Nevertheless, disciplining an employee may be needed on occasion.

Not disciplining when needed sends the wrong message to an employee and, more importantly, to other employees. Reasonable discipline is important. The penalty should be consistent with the rules violation. Permitting the employee to maintain self-respect is an important part of discipline. Therefore, discipline the employee's behavior or act, do not berate him or her as a person.

Basic to effective discipline is an employee handbook or other form of written statement of policies, practice, and work rules. Employee orientation should include a review of the handbook, with employees given ample opportunity to raise questions. **Progressive discipline** is more effective than an "all or nothing" approach. Progressive discipline increases the severity of punishment as an offense is repeated. Typical levels in progressive discipline are:

- An informal talk.
- An oral warning or reprimand.
- A written warning.
- Disciplinary layoff.
- Termination.

On occasion it may be necessary to dismiss an employee. This may be the result of discipline problems or just the failure of an employee to live up to expectations and job requirements. Dismissal is a serious matter with potential for legal and personal consequences. Therefore, any dismissal should be preceded by **notice**, attempted **rehabilitation**, and **consistency**. **Notice** includes evidence that each employee has knowledge of policies, practices, and work rules. Notice also includes periodic performance evaluations. The results of the evaluations should be discussed with the employee and made available in written form.

Rehabilitation includes efforts to correct problems such as progressive discipline for being tardy. Efforts to improve performance problems are also important. Examples include additional training, change of jobs, and help of other employees. All rehabilitation efforts should be carefully documented. All employees should be treated in a manner **consistent** with the business' policies, practices, and work rules.

Employee dismissal/quitting

Dismissing a worker usually is not a pleasant experience. But Harvey Mackay[4] puts this task in perspective: "It isn't the people you fire that make your life miserable; it's usually the people you don't."

Notice of dismissal is best given in writing and in a private setting, with a calm discussion of the reasons for dismissal. Many employers allow the employee time to look for a new job while still on the payroll, i.e., after notice has been given and until the dismissal becomes effective. All matters related to a disciplinary problem and the steps leading to dismissal should be carefully summarized in writing and put in the employee's file.

If an employee quits, conduct an exit interview to find out why. Evaluate the reasons given and make any changes that would improve or correct the situation for current or future employees.

Application: Carrying out these management functions in three different settings

The way one executes the four personnel management functions will vary by situation.

Situation 1. Managing temporary (occasional) employees

In training temporary employees, keep the approach fairly simple, though sufficient for them to do designated tasks efficiently and effectively. Do not invest heavily in their training or assign them tasks requiring considerable training. Over time, consider investing more training in those who show potential and an interest in staying longer than originally planned.

For temporary employees, develop **work plans** and **schedules**, and exercise close **supervision**. Put on the "My Way" hat because these employees often tend to view this job as just a means to an end. For example, working may be solely for the purpose of securing money to meet various personal needs, or to have some income until a permanent position can be found.

4. Harvey Mackay, *Swim With The Sharks Without Being Eaten Alive*, Ballantine Books, 1988, Page 173.

If temporary employees stay on longer than planned and gain skills, they may be ready for a more participative type supervision, become more committed to the objectives of the business and give priority to higher order personal needs.

Situation 2. Managing the small farm work force

The work force on many U.S. farms consists of the operator, some unpaid family members, and a regular hired employee or two. Such a situation often breeds personnel management problems. Usually the farm operator continues to work as hard as if there were no hired employees involved, and thus remains basically a doer. He/she has had little experience in managing employees, so the major objective is often to make sure that an employee works as hard or harder than the operator and family members.

To avoid these problems, first prepare a job description for the employee. If at all possible, the employee should be given responsibility for specific tasks. In allocating these tasks, do not give the employee all of the unpleasant ones; show leadership by taking on some of these less desirable tasks.

In this setting, managing the family-member work force also may become a problem. Just because family members can be viewed as a "captive" work force does not mean that the manager can rely on or revert to the "stick" approach. Many times parents wonder why their children do not want to farm with them later on. The reason is likely due to the way they were treated earlier. Treat family members in a manner like that needed to hire and keep good employees. It may be helpful to remember, especially with children, that their experience working on the farm is training them to be effective future workers and possibly managers.

Situation 3. Managing skilled and supervisory employees

There are at least three requirements for managing skilled and supervisory employees:

1. Commitment to the goals of the business.
2. Adequate skills and knowledge for the job.
3. The inner drive to use their skills to achieve personal and business goals.

For this to happen a manager must:

- Delegate responsibility to get the employee's or supervisor's commitment.
- Provide adequate training and counseling to make full use of their skills.
- Use positive feedback and motivation to give the employees extra drive.

Give each employee at least one specific, challenging task directly related to the achievement of the farm business goals. There must be a definite **delegation of responsibility**. Give the employee sufficient authority to make necessary decisions—crediting them for successes and holding them accountable for failures. Therefore, one must be sure that business goals are initially clear and that rewards and penalties are spelled out.

The amount of training needed at this level varies with the capabilities of employees and the tasks involved. At the outset, carefully explain the nature of the job and provide any training that seems appropriate or is requested. As time goes by, check with employees as to their desire to improve their skills and possibly take on more responsibility. Here, some careful coaching, counseling, and feedback are needed.

The extent to which a manager is required to do **work planning and scheduling** will vary. Skilled employees may need some direction, while supervisory employees will need to be doing such planning for the employees they supervise. The manager's role in **motivating** skilled employees is vital. Employees need to feel that they are growing in the job, are receiving proper recognition, and feel a growing degree of personal fulfillment. This will require close communication and continual feedback. Review wages, incentive plans, and fringe benefits to properly reflect the employee's progress and worth to the business.

Labor laws and regulations; records needed to comply

Numerous federal and state laws and regulations affect the employment and working conditions of employees. Since both federal and state laws and regulations are in a constant state of flux, and often vary from state to state, only the general characteristics of these farm labor laws and regulations will be reviewed here. Thus, farm personnel managers should check the laws and regulations specific to their states. Regular monitoring of changes and proposed changes in laws and regulations is important. Employees may have incorrect information leading to unfounded expectations. Without current information, employers cannot be certain of compliance. *However, ignorance of the law is not a valid defense.*

Following is a discussion of laws and regulations pertaining to:

- Employment relationships.
- Human rights provisions.
- Minimum wage and child labor laws.
- Income and social security taxes.
- Unemployment insurance.
- OSHA regulations and workers compensation.
- Migrant worker provisions.

Employment relationships: Definitions and related issues

When a farm operator hires a person, a legal relationship is established. The relationship may be that of employer/employee, independent contractor, or principal/agent. Special concerns may arise in the hiring of a crew leader with migrant labor.

The employer/employee relationship

The employer/employee relationship is the most common form of employment relationship. Important issues are: (1) when the agreement must be in writing and, (2) the employer's liability with respect to employees.

The oral vs. written agreement. Most farm employer/employee agreements are oral and often do not specify the length of time or term the employee is to work. Such oral contracts are valid if the person is employed for an **indefinite term** or a term that will end within one year from the date of employment. Courts tend to hold that an employee hired for an indefinite time is hired at will. In most cases, this means that the employee may quit or be dismissed at any time, without incurring any liability or acquiring any rights because of quitting or dismissal.

If the **term** of employment agreed upon is for a specified period of a year or more, the agreement **must be in writing** (Statute of Frauds). In any case, the author recommends a written agreement with regular employees. Many disputes and misunderstandings can be avoided if an agreement is worked out carefully and put in good legal form. See discussion of written employment agreements in Chapter 4.

Liability with respect to employees. Of the three possible legal classifications (employer/employee, independent contractor, or principal/agent) an employer has the greatest degree of control over an employee, and as a result the greatest liability for their actions. An employer may be held liable for acts of employees, as well as for injuries they incur while acting within one's employ.

Liability for acts of employees. The basic question here is: was the employee acting within the scope of employment at the time? If the answer is yes, then the employer is generally held liable for the acts of employees. However, if a manager has given specific instructions that an employee did not follow, and in turn caused injury to another person or to another's property, a manager is certainly in a position to dismiss the employee and possibly require them to reimburse the business for any damages caused. But, the manager/owner would be liable to the third party for damages. This is known as vicarious liability.

Liability for injuries to employees. There are certain legal obligations to employees. Farming is a very accident-prone occupation. Thus, failure to face these realities could wipe out a business. Today, most farm businesses of any size must carry workers compensation insurance. This insurance is designed to cover the medical costs of injured workers, provide partial supplementation of lost wages, and provide disability income when necessary. Though some employees are not covered by this insurance, it is likely that if they were injured, a suit would be brought against the employer for compensation that the employee would have received under workers compensation. In such a situation, the farm manager should have in place an adequate insurance program to cover such an outcome.

But, in any case, it is important that an employer establish a safe work environment:

- Provide reasonably safe tools and appliances.
- Warn employees of any dangers that they could not reasonably be expected to know about.
- Employ competent, safety-oriented fellow employees.
- Make reasonable rules for the conduct of employees while at work.

The independent contractor relationship

The employment of custom operators in farming is a practice of long-standing. This may include hiring for selected field operations, feed grinders, spray operators, contract feeders, etc. On occasion, however, farm operators get into a "gray" area, claiming independent contractor status to avoid the employer's portion of social security taxes, as well as unemployment and workers compensation insurance, that would be an issue if the arrangement were employer/employee. There are also liability issues.

The key concern the manager should have is whether the proposed independent contractor (contractee) arrangement will pass muster. If it doesn't, there are potentially substantial tax and liability consequences. Thus, the adage "if you're going to call it a duck, it better walk and quack like a duck" holds here.

To be considered an independent contractor, the contractee:

- Works his/her own schedule; does work in his/her own way.
- Uses his/her own methods and receives no training from the purchaser (farmer).
- Provides tools, machinery, etc., to perform services.
- Is able to assign one of his/her employees to do the job.
- Hires, supervises and pays workers as a result of the contract.
- Is hired to do one or more jobs. No continuous relationship exists.
- Is free to do work when and for whom he/she chooses.
- Works for a number of persons or firms during the same time period.
- Cannot be fired and cannot quit; he/she must complete the work to receive payment.

- **Liability for acts of independent contractors.** The employer has the least amount of control over an independent contractor. As the name suggests, an independent contractor is a person or organization independently performing a job without the employer's control except of the result. An employer has no control over the manner in which the job gets done.

As a general rule, an employer is not responsible for the negligent acts of an independent contractor. But, there are some important exceptions:

- Negligence in selecting a contractor.
- Furnishing a contractor with faulty plans or specifications.
- Keeping the immediate area in which the contractor is working open for business.
- Hiring a contractor to perform a task that is inherently dangerous.

- **Consequences of an independent contractor being ruled an employee.** The line between independent contractor and employer/employee status—gray to begin with—is sometimes blatantly ignored. However, the IRS is cracking down on employers who have abused the tax system, **including Social Security deductions**, by treating employees as independent contractors. The employer is the responsible party. If an employer makes the wrong choice, he/she may have a substantial social security tax bill to pay if a supposed independent contractor is determined to be an employee.

The employer should also be aware that, if an independent contractor worker is injured and it is proven that the person was in fact an employee, the uninsured employer could be subject to payment of 150% of all benefits paid out to the injured employee. Increased workers compensation insurance rates may also occur.

Migrant farm workers have almost never been considered independent contractors. They are considered employees. This is true even when a crewleader is used. As migrants are by definition itinerant, are not in business for themselves, have no investment in equipment, and are not considered highly skilled as to field labor, the "test" works somewhat differently than these elements may at first suggest.

When considering the independent contractor route, first review the situation with a tax consultant and an attorney to ensure that the proposed relationship will pass muster.

Agency: The principal/agent relationship

A farmer may create a principal-agent relationship with another party, whereby, the agent is authorized to represent the farmer in business dealings with third parties. An employer is responsible for an agent's acts committed while within the scope of the authority granted by the employer. That authority may be **expressed** or **apparent.** If the agent carries out **expressed** directions, the employer is responsible for the acts since they are within the scope of expressed authority.

The **apparent** authority area can also get an employer into trouble. For example, an employer specifically forbids an agent from buying certain new tools. The agent does it anyway, charging the cost to the employer's account. Because of previous dealings with the farm supply store, it would appear to the store owner that the agent had the authority to make the transaction. In such a case, the employer may be held liable for payment regardless of whether or not the agent had been authorized to make the purchase. The fallout from this may be twofold: the employer pays the bill and dismisses the agent.

The use of crew leaders

The use of **crew leaders** with migrant workers (also known as **farm labor contractors**) is thoroughly regulated by Federal Statute. Hiring a crew leader will not insulate an agricultural employer from his/her responsibilities. In fact, the agricultural employer and the crew leader may be considered **joint employers**, giving rise to joint liability for the improper acts of the crew leader.

Immigration Reform and Control Act. The Form I-9

The Immigration Reform and Control Act of 1986, requires that an employer do the following regarding migrant employees:

- Have employees fill out their part of the Form I-9 when they are hired. This requires that the employee be a U.S. citizen or naturalized in the U.S., a permanent resident, or an authorized alien. *Persons hired before November 7, 1986 and still working for the same employer do not need to complete this form.*

- Check documents establishing employee's identity and eligibility to work.

- Properly complete the employer's section of Form I-9.

- Retain the worker's Form I-9 for at least three years. If the person is employed for more than three years, the employer must retain the form until one year after the person leaves the employ.

- If requested, present the Form I-9 for inspection by the Immigration Service of the Department of Labor.

- Employers will be required to file periodic reports with the Immigration and Naturalization Service.

Human rights provisions and concerns

The human rights of employees or potential employees must be observed. Human rights concerns are present when one hires, manages or dismisses employees.

- When **hiring** employees, the employer must make sure that any job descriptions, job advertisements, as well as interviewing and hiring activities are all done in a fair, non-discriminatory manner.

- When **managing** employees, the employer must be sure that the way he/she manages them and the amount paid them is fair and shows no form of discrimination. Also, no form of sexual harassment can be tolerated.

- When **dismissing** an employee for reasons other than blatant violation of work rules, the employer should be able to demonstrate the use of progressive discipline. These steps should be carefully documented. Otherwise, the employer could end up in a lawsuit for unlawful discharge.

This is a very complex area of law; employers need to keep abreast of it. Seek competent advice as situations arise. Several of these issues were discussed in the previous chapter and in earlier sections of this chapter. When in doubt, check with an attorney or the State Department of Human Rights.

Minimum wage and child labor laws

Under federal laws, many farm workers are not covered by minimum wage laws. However, any employer who used more than a specified number of worker-days of labor in any calendar quarter is required to pay at least a minimum wage. State laws may be more stringent than federal law. The minimum wage rate is also subject to change. Check the rate for the state in which the business is located and whether minimum wage is required.

Keep the records needed for minimum wage purposes for three years and include the following: name, address, occupation, rate of pay, amount paid each pay period, and the hours worked each day and week, including beginning and ending hours each day.

Child labor regulations relate to children employed on a farm. Age 16 is usually the minimum age for employment in agriculture during school hours. Outside of school hours, the minimum age for employment is 14, with two exceptions: children ages 12 or 13 can be employed with parental written consent, and children under 12 can work on their parents' farm.

Additional child labor regulations apply to jobs classified as hazardous. Hazardous jobs include:

- Working with agricultural chemicals.
- Driving and operating farm machinery, e.g. tractors, combines, corn pickers, and mowers.
- Working with breeding stock, such as bulls and boars.

Children under age 14 cannot be employed in hazardous jobs. Children 14 and 15 can be certified for certain hazardous jobs. State extension services and other agencies provide training for necessary certification.

Income and social security taxes

Withholding employees' **federal and state income tax** on their wages by the employer is required. The employer needs to secure a federal and state tax identification number. It should also be noted that both cash and noncash wages are subject to taxation. At this writing, not all states require income tax withholding, but the employer may withhold if the employee requests it. Eventually, all states will require withholding of the tax.

Social security taxes must be withheld and paid for agricultural employees if cash wages exceed a certain amount. Only cash wages are subject to the social security tax. Generally, wages paid to the employer's children, who are under age 18, are not subject to social security tax in a sole proprietorship. Check with an accountant or the social security office for the current regulations.

Records needed for income tax and social security tax purposes include:

- The employee's name and social security number.
- The amount of wages paid in cash.
- The amount of tax withheld.
- The number of days worked.
- The amount of non-cash wages paid.

A W-2 form must be provided each employee by January 31 of the year following employment.

Unemployment insurance

Unemployment insurance is designed to cover the loss of income from unwillful unemployment (job loss). State law may be more inclusive than federal laws, so check both sets of laws. Both cash and non-cash wages are taxable. The rate varies according to the balance in the state's unemployment fund and the employer's experience rating.

Employers need to keep records of the number of employees on a weekly basis as well as the amount of their wages. Records concerning dates of termination of employment of previous employees and reasons for the termination are also important. Such records are essential in determining how a previous employee's unemployment is rightfully charged by the state agency administering the program.

OSHA regulations and workers compensation insurance

Occupational Safety and Health Act (OSHA) regulations affect many farms and farm employees. The purpose of OSHA regulations is to provide safe working conditions and to thus eliminate accidents on the job. Check with the state department of labor regarding OSHA regulations and reporting requirements.

Workers' compensation insurance provides compensation to employees who have a work-related injury or disease. Compensation benefits may include partial wage replacement, loss of use or function compensation, payment of medical and rehabilitation costs, and death benefits. Coverage and costs vary substantially among states.

Migrant worker provisions under federal law

Migrant workers come under the provisions of the Federal Migrant and Seasonal Workers Protection Act. Three key provisions include the need to:

- Use a certified farm labor contractor/recruiter in securing migrant workers.
- Provide the migrant worker with an employment statement when employed.
- Meet special guidelines in terms of hours worked, payment terms, and records to be kept. Federal and state standards for housing, safety and health of migrants must be observed.

Figure 5-1. A performance appraisal check list for managers.

The following check list is designed to guide the manager in preparing, conducting and following through on employee performance appraisal discussions.

I. Personal preparation

☐ I have reviewed mutually understood expectations with respect to job duties, projects, goals, standards, and any other predetermined performance factors pertinent to this appraisal discussion.

☐ I have observed job performance measured against mutually understood expectations. In so doing, I have done my best to avoid such pitfalls as:

______Bias/prejudice.
______The vagaries of memory.
______Over-attention to some aspects of the job at the expense of others.
______Being overly influenced by my own experience.
______Trait evaluation rather than performance measurement.

☐ I have reviewed the employee's background including:

______Skills.
______Work experience.
______Training.

☐ I have determined the employee's performance strengths and areas in need of improvement and in so doing have:

______Accumulated specific, unbiased documentation that can be used to help communicate my position.
______Limited myself to those critical points that are the most important.
______Prepared a possible development plan in case the employee needs assistance in coming up with a suitable plan.

☐ I have identified areas of concentration in setting goals and standards for the next appraisal period.

☐ I have given the employee advance notice of when the discussion will be held so that he/she can prepare.

☐ I have set aside an adequate block of uninterrupted time to permit a full and complete discussion.

II. Conducting the appraisal Discussion

☐ I plan to begin the discussion by creating a sincere, but open and friendly atmosphere. This includes:

______Reviewing the purpose of the discussion.
______Making it clear that is a joint discussion for the purpose of mutual problem-solving and goal setting.
______Striving to put the employee at ease.

☐ In the body of the discussion I intend to keep the focus on the job performance and related factors. This includes:

______Discussing job requirements–employee strengths, accomplishments, improvements needs and evaluating results of performance against objectives set during previous reviews and discussions.
______Being prepared to cite observations for each point I want to discuss.
______Encouraging the employee to appraise his/her own performance.
______Using open, reflective and directive questions to promote thought, understanding, and problem solving.

Figure 5-1 (continued). A performance appraisal check list for managers.

☐ I will encourage the employee to outline his/her personal plans for self-development before suggesting ideas of my own. I the process, I will:

______Try to get the employee to set personal growth and improvement targets.

______Strive to reach agreement on appropriate development plans which detail what the employee intends to do, a timetable and support I am prepared to give.

☐ I am prepared to discuss work assignments, projects, and goals for the next appraisal period and will ask the employee to come prepared with suggestions.

III. Closing the discussion

☐ I will be prepared to make notes during the discussion for the purpose of summarizing agreements and follow up. In closing, I will:

______Summarize what has been discussed.

______Show enthusiasm for plans that have been made.

______Give the employee an opportunity to make additional suggestions.

______End on a positive, friendly, harmonious note.

IV. Post appraisal follow up

☐ As soon as the discussion is over, I will record the plans made, points requiring follow up, the commitments I made, and provide a copy for the employee.

☐ I will also evaluate how I handled the discussion.

______What I did well.

______What I could have done better.

______What I learned about the employee and his/her job.

______What I learned about myself and my job.

Source: *Effective Performance Appraisals* by Robert B. Maddux, Crisp Publications, Inc., Los Altos, CA, 1987, pages 58-59.

NCR Publications Available Through MWPS

NCR-2	Income Tax Management for Farmers
NCR-43	Tax Planning When Buying or Selling a Farm
NCR-56	Long-term Installment Land Contracts
NCR-406	Managing Risk in Agriculture
NCR-568	Planning the Financial/Organizational Structure of Farm and Agribusiness Firms: What Are the Options?

Rental Arrangement Series

NCR-75	Fixed and Flexible Cash Rental Arrangements for your Farm
NCR-105	Crop-share or Crop-share/Cash Rental Arrangements for your Farm
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