Intensive Forest Management

3. Shifting Rowcrop and Pasture Land to Tree Crops in Georgia: Long-term Land Lease for Oldfield Timber Crops Examined

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PURPOSE

The purpose of this publication is to provide a format to examine the nature of leases being offered for marginal crop and pasture land and to detail the advantages and disadvantages for such leases.

INTRODUCTION

In 1988, in Georgia, there were 23.535 million acres of timberland, 6.568 million acres of cropland, and 2.977 million acres of pasture land. Of the total 9.545 million acres of agricultural land, 1.864 million acres, 19.5 percent, were classified as marginal cropland and pasture (Soil Conservation Service in Land Capability classes 3e, 4e, 6, and 7), including 659 thousand acres of highly erodible cropland, that could yield higher rates of return in pine plantations than in crop or pasture use (USDA-FS 1988, p. 251-257).

SITUATION

While much land in Georgia may be best suited for timber and forest production, many landowners perceive converting marginal rowcrop and pasture lands to tree crops, as a decline in productivity. On the other hand, substantial areas of forest cover have been periodically removed and converted to marginal agricultural uses or harvested with no provision for regeneration of the land to suitable forest cover. This loss of potential forest productivity has continually caused concern among foresters and policy makers because of the broad economic impacts that could occur from diminished timber production.

Of the 1.864 million marginal cropland and pasture acres identified in Georgia in 1988 (including 659 thousand acres of highly erodible cropland (USDA-FS 1988, p. 251-257)), only 706,459 acres were entered into the Conservation Reserve Program (CRP), with 645,931 acres planted to trees (Glaser 1986, USDA-ERS 1994, USDA-ASCS 1993).

Consequently, there remains, by conservative estimate, approximately 1.218 million acres of marginal crop and pasture land in Georgia that could yield higher rates of return in pine plantations.

LEASING CONTRACTS

Five types of contracts involving long-term management of timber production are described by Green (1979) as follows:

1) Timber purchase and land lease involves firms buying timber outright and leasing land for management. Lump sum payments are made for standing timber with periodic payments for land lease. The timber purchase qualifies for capital gains treatment with the land lease payment as ordinary income.

2) Lease of land and timber includes both for management purposes. Siegel (1973, 1974) includes lease of bare land in this type lease. There are periodic and/or lump sum payments. The usual tax treatment of income is for the payments made to market value of timber at start of contract as capital gains with additional payments as ordinary income.

3) Land leases with cutting contracts involves firms leasing land for management and buying timber as it matures. There are periodic payments for land lease with payment for timber as it is harvested. Land lease payments are treated as ordinary income for tax purposes with timber payments as capital gains.

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4) Cutting contracts have the leasing firm managing land and buying timber as it matures. Payment is made for timber as it is harvested, or there may be periodic maintenance payments with shortages made up as timber is harvested. The usual tax treatment of income is as capital gains.

5) Increment contracts provide that the firm credits the landowner an amount based on an estimated annual amount of fiber his land can produce under management. Periodic payments are made for the credited increment (typically 65 to 75 percent) with shortages made up as timber is harvested. Income is treated as capital gains.

As a result of increasing stumpage demand across the South, leases for timberland are becoming more common in the region. The practice increased as contracts for tree crops planted under the CRP began expiring in 1995. Leases offered for these pine plantations have been primarily for a ten-year period beginning at expiration of the CRP contract and ending with a clearcut harvest of the stand at age 20 (Beckwith et al. 1996). These leases have typically been for land and timber as described under 2) above. Siegel (1973, 1974) indicates that 10 years is the most prevalent minimum lease length with nearly three-fourths of the agreements made for 21 years or longer.

A natural extension of these leasing practices is currently being applied through the private sector for full-rotation tree crops targeted for the millions of marginal agricultural crop and pasture land in the U.S. South. Further, these lease offerings through the private sector could partially substitute for public policy programs designed to convert land use to long-term sustainable tree crops. Moreover, marginal lands converted from annual rowcrop and pasture production to tree crops can reduce soil erosion, improve water quality, and produce more profitable returns for the landowner.

METHODS

Advantages and disadvantages of long-term land leasing for tree production were identified through discussion interviews with landowners experiencing lease offers, and with county extension agents working with those landowners (Dangerfield et al. 1995, Beckwith et al. 1996).

RESULTS: LEASES DISCUSSED

Proposition -
Make a long-term commitment to lease crop and/or pasture land for production of timber.

Offer: Lease rowcrop land for $82 per acre, per year for 24 years.

Reaction -
Great deal! . . . Bad idea! You decide.

Details -

Example: Lease your rowcrop land to someone to grow trees on for 24 years. They pay you $82 per acre per year for 24 years. Then, they clear-cut the trees and leave you with cut-over forest land. This is one offer being made now.

Advantages -
The present value of $82 per acre per year for 24 years at 8 percent interest is $863.36. This investment could yield assured, high average per acre annual income for the entire land tract. This dependable, annual income can help smooth cash-flows of other business or personal income. Also, the landowner would avoid paying ad valorem taxes at tree harvest of approximately 2.5 percent of standing tree value (Dangerfield et al. 1993). Such a long-term land lease contract can diversify farm production and spread risks by adding trees to annual cropping enterprises (Zinkhan 1992). Leasing marginal rowcrop and pasture land for tree production reduces landowner risks of lost income from the land during poor cropping years.

Establishing tree crops in place of annual crops on marginal land provides an opportunity to reduce total pesticide and fertilizer applications, reduce soil erosion, and improve water quality. On some soils, production of tree crops may have more long-run environmental and economic benefits for society, than annual rowcrops or pasture.

Disadvantages -
Whole-tract conversion of rowcrop or pasture land to tree crops may be made without complete consideration for productivity/profitability on specific acres that may be better suited to annual crops versus tree crops. Such areas could to be separated from the remainder of the tract when considering long-term leasing for tree crops.

Landowners with good tree management skills could expect to earn more money from growing tree crops themselves, compared to earning returns from long-term land leasing for tree crops. When leasing land, landowners would pay ordinary income taxes on land lease income, thereby losing the benefits of a reduced long-term capital gains rate under the new tax structure.
Considerations -
Initial lease proposals should be considered starting points for a negotiated agreement. The price, lease time period, and retained rights to uses that do not restrict timber production should be considered part of the discussions. For example, items such as annual ad valorem property tax on land, road and drainage improvements, timber harvest activities, and hunting or other non-timber activities, etc. should be addressed.

Include adjustment provisions for some type lease rate escalation clause using an established index such as the All-Commodities Wholesale Price Index of the U.S. Department of Labor for increases in land and timber (Siegel 1973, 1974). Alternatively, indexes derived from local and/or regional market information can be used.

Assurances of appropriate protection from conditions that would negatively affect leased timberland and surrounding areas should also be secured. An agreement about after-lease land conditions, such as tree replanting, should be made to assure its fair and reasonable use following the lease period. Finally, some means of modifying the lease agreement during the lease period should be obtained, as protection to both parties in dealing with future situations.

Appreciate that marginal acres leased for growing long-term timber crops are lost to rowcrop or pasture production during the tree rotation. However, trees are a major agricultural crop in the U.S. South. Therefore, leased land would remain “in agriculture”, and in fact may be better protected from non-agricultural “development” than when in annual crops.

With a shift from rowcrops or pasture to tree crops there is some loss of management flexibility while growing timber, and conversion of forest acres to rowcrop uses is expensive. However, when planting and growing your own timber, you can increase management flexibility and generate annual or periodic income by adding hunting leases, leasing or producing pine straw, or mixing other enterprises with the trees, such as livestock grazing, to increase income.

Perspective -
Generally, landowners who desire or need income security that long-term leases offer, could benefit from conversion of their marginal land from rowcrops and pasture to tree crops. The annual cash-flow from lease payments can provide payment for current debts or planned expenses. However, landowners favoring maximum, annual management flexibility could benefit more from keeping their land in annual crop production. Alternatively, landowners wanting to maximize timber income, and assume the consequent responsibilities, could benefit more from growing their own trees and hiring timber expertise as they need it.

Further, there is a long-term projection for profitability of producing tree crops. Well managed tree crops can earn an annual equivalent value (AEV) upwards of $100 per acre per year. Income from well managed tree crops can compete favorably with income from production of many annual crops on some soil types.

Leasing out land for long-term tree crops shifts the risk of loss from tree production from the landowner to the lessee. In addition, the total risk of loss from tree production should be lower under the supervision of a lessee with a high level of forest management capability.

SUMMARY/CONCLUSIONS
When examining any lease option, landowners should consider the following:

Leasing considerations:
* Leasing for tree production is a new option — Go Slowly
* Check-out leasing company
* Consider leasing only part of land
* Consider tax implications on income earned
* Include adjustment provisions for lease rate escalation
* Consider tree replanting
* Consult a lawyer before signing any lease agreement
* Lease only the specific resource (growing trees), not full use of the land
* Leasing may pay if:
  * you want dependable, passive annual income
  * you have no forestry expertise
  * you want to transfer risk of loss or gain to someone else
  * your marginal crop or pasture acres earn lower returns than leasing
* Leasing may NOT pay if:
  * you can manage periodic income from tree crops
  * you have good forestry management expertise
  * you want to manage the risk of loss or gain yourself
  * your marginal crop or pasture acres earn higher returns than leasing

With respect to long-term land lease rates for tree production, a wide range of financial performance returns are pos-
sible. Factors influencing these returns include the level of investment in management (including weed competition control, fertilization, and thinnings), product prices earned through marketing, and length of scenario rotation (planning horizon).

There appears a wide range of financial performance between 20-year rotations with medium management and timber prices and 24-year rotations with high management and prices. This range allows landowners with relatively lower management skills to earn higher forestry investment returns by leasing out land. The range also allows lessees with relatively higher management skills to purchase long-term leases at a cost low enough to earn attractive financial returns. Alternatively, landowners with good forestry management skills, or with access to hired skills, can earn forestry investment returns well above annual crop production systems on marginal crop or pasture land.

**Recommendations**

Before entering into a lease agreements, landowners must prioritize landownership/production objectives.

Alternative land uses should be evaluated by examination of:

1) soil productivity classes present on the land tract;

2) prospects for future rowcrop and timber markets in the area;

3) landowner willingness to assume land management responsibilities found under alternative cropping scenarios; and,

4) opportunities for negotiating favorable leases.

If tree crops are selected, they should be managed responsibly as any agricultural crop. Landowners should be aware of the importance and costs of reforesting cut-over timberland at the expiration of a long-term timber lease.

Landowners can earn their greatest monetary returns by growing their own trees from planting to financial maturity. But, more landowner inputs are required to grow their own trees. Generally, fewer dollars are earned by landowners leasing out their marginal land for long-term tree production than when planting and managing their own trees. Also, realize that less landowner inputs are required when leasing out. However, with leasing, cash-flow is greatly improved for the landowner compared to growing trees themselves. In total, leasing remains an important option and can be a win/win experience for landowners and lessees.

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**Literature Cited**


