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MEMORANDUM

To: All Irrigation Districts Subject to the Acreage Limitation Provisions of Reclamation Law

From: J. Austin Burke *J. Austin Burke*
Acting Director, Program Analysis Office

Subject: Lease Renewals and Extensions and Reclamation Reform Act of 1982 Requirements

The following provides guidance on how lease renewals and extensions, including annual leases, are treated for purposes of determining the duration or "term," of a lease. Also addressed is the treatment of lease renewals, lease extensions, and annual leases in association with the Reclamation Reform Act of 1982 (RRA) forms submittal requirements. Attached for your convenience are examples of various leasing situations (attachment 1) and a flow chart illustrating the points made in the memorandum (attachment 2). The following guidance concerning the treatment of annual leases and the associated RRA forms submittal requirements became effective on October 1, 1996. Accordingly, that change in policy will not be used to address problems associated with annual leases and RRA forms submittal requirements that occurred before October 1, 1996, regardless of when the Bureau of Reclamation (Reclamation) discovers the problem. The other information provided in this memorandum has been longstanding Reclamation policy. It has been provided to help answer some of the more frequently asked questions.

General RRA forms requirements for lease renewals and extensions:

Lease renewals or extensions change the particulars of a lease, including but not necessarily limited to, the term of a lease. The RRA and the Acreage Limitation Rules and Regulations specifically address certain conditions that leases must meet if leased land is to be eligible to receive Reclamation irrigation water. This includes limits to the term of a lease. Therefore, lease renewals or extensions are considered landholding changes (at a minimum, changes to the effective date of the lease or the term of the lease), and require the submittal of new standard RRA forms for those landholders with landholdings that exceed the applicable RRA forms submittal threshold. Verification forms (Form 7-21VERIFY) may not be submitted in lieu of standard RRA forms in such cases, except as provided below.

Can the parties to a current lease immediately enter into a new lease for the same land upon expiration of the current lease?

Yes. Furthermore, the new lease can have exactly the same terms as the current lease. Reclamation will not view such action as a continuation of the original lease for purposes of applying the statutory limits concerning the term of a lease. However, the term of each individual lease cannot exceed the statutory lease term limits. Those limits are generally 10 years, or up to 25 years for perennial crops (as determined on a crop-by-crop basis) that have average life spans of more than 10 years. Examples of multi-year leases are found in examples 2, 3, and 4. In addition, for landholders subject to the discretionary provisions, the rent paid must reflect the reasonable value of the irrigation water to the productivity of the land.

RRA forms requirements: Because there is a new lease document with a new effective date and term, new standard RRA forms must be submitted (for those landholders whose westwide landholdings exceed the applicable RRA forms submittal threshold), even though neither the parties to the lease nor the land involved may have changed. Because this is considered to be a new lease, the verification form (Form 7-21VERIFY) cannot be used.

Can landholders simultaneously enter into multiple lease agreements for the same land where the total term of all the lease agreements exceeds 10 years or the applicable time limit for a particular perennial crop?

No. Simultaneously entering into multiple leases is permissible only if the total term of the multiple lease agreements does not exceed the statutory 10-year lease term limit (see example 1). Only leases of land where a perennial crop will be the primary crop produced are excepted from the 10-year lease term limit, provided the average life span of the perennial crop exceeds 10 years and the total term of the multiple leases does not exceed the average life span of the crop being grown, as determined by Reclamation. However, such leases must be reviewed and approved by Reclamation. Contact your local Reclamation office for any needed information on the average life span of perennial crops.

What are annual leases?

For acreage limitation purposes, annual leases are only those that (1) have an effective term of 1 year or less, and (2) have a clause requiring that annual affirmative action be taken in writing, or have a clause providing for annual withdrawal opportunity from the lease.

Can an annual lease be renewed?

Yes. An annual lease can be renewed or extended indefinitely as long as both the original lease and any renewal or extension of it each meet the 1 year or less requirement. Examples of annual leases are found in examples 5 and 6.

RRA forms requirements: Starting with the 1997 water year, renewals or extensions of *annual leases* as defined above will not automatically be considered landholding changes requiring the submittal of new standard RRA forms. In order to qualify for this exception to the landholding change requirements, all of the following criteria must be met: (1) the lessor(s), lessee(s), or the land being leased cannot change as part of the renewal or extension, (2) any actual renewal or extension of an annual lease also must have a term of 1 year or less, and (3) the original lease must provide for annual, written affirmative action or annual withdrawal opportunity, or be amended in writing to do so. If these criteria are met, verification forms (Form 7-21VERIFY) that request necessary information concerning the annual lease renewal or annual lease extension may be submitted in lieu of standard RRA forms. Otherwise, a standard RRA form must be submitted.

Why is an annual lease, as defined, treated differently than any other lease?

Congressional intent behind limiting lease terms is based on ensuring that an "arm's length" relationship is maintained between the lessor and the lessee. In the case of an annual lease, each year the lessee and the lessor have the opportunity to change the provisions of the lease, terminate the lease without cause, etc. It also ensures that other farmers may have an annual opportunity to farm the land being leased and, as the lessee, benefit from the subsidy being provided by the Federal Government. The same assurances and opportunities are not provided by a lease that ties up land for a substantial number of years, which Congress defined as more than 10 years with exceptions for certain perennial crops.

What are the meanings of "effective date" and "term" for purposes of RRA forms completion?

For lease renewals (including those for annual leases) that result in a new lease document, the "effective date" requested on the RRA forms is the date of the lease renewal (e.g., January 1, 1998), with the "term" being the period of time specified in the new lease document that the lease will be in effect (e.g., 1 year or less for annual leases).

For extended leases or annual lease renewals that do not result in a new lease document, the "effective date" is the original date of the lease. The "term" for annual leases is 1 year or less, and for other leases the "term" is the total of the original term plus any subsequent extensions (see the next paragraph and the examples in attachment 1 for explanation and illustration of calculating total lease term).

How is the term of a lease calculated when renewals or extensions are involved?

Section 227 of the RRA requires Reclamation to include any exercisable options to the established term of a lease when determining if the statutory maximum length of a lease has been exceeded. Therefore, if a lease includes an exercisable option for extension or renewal, the time period for such will be added to the original term to see if the overall term of the lease exceeds 10 years (up to 25 years for perennial crops with average life spans of more than 10 years, depending on the particular perennial crop). The only exception will be that provided above for annual leases (as defined earlier). If a lease other than an annual lease does not include the benefit of an exercisable option to renew and the parties to the original lease wish to continue leasing the same land, a new lease document must be created.

This memorandum provides only general guidance. Since leasing situations can vary greatly, please contact your local Bureau of Reclamation office if you have any questions, special situations, or need further assistance.

ATTACHMENT 1: Examples of Various Leasing Situations

EXAMPLE 1 - *Multiple lease agreements*

On January 1, 1995, Landowner A enters into a series of leases for a land parcel with Farmer B, for the production of annual crops. The terms of the leases are as follows:

Lease 1 from January 1, 1995, to January 1, 2005

Lease 2 from January 1, 2005, to January 1, 2015

Lease 3 from January 1, 2015, to January 1, 2025

These leases violate the statutory lease term limit. While no individual lease is more than 10 years in length, the action taken on January 1, 1995, effectively ties up the land for 30 years, which exceeds the 10-year lease term limit.

EXAMPLE 2 - *Lease (other than an annual lease) with renewal option*

On October 1, 1990, Landowner X enters into a lease agreement with Farmer Y. The effective date of the lease agreement is January 1, 1991, with the agreement in effect through December 31, 1999. The lease also includes an option that states the lease may be renewed for 1 year.

Assuming no perennial crops are grown, this lease meets the statutory leasing criteria concerning the term of the lease and is acceptable for acreage limitation purposes because its total effective length is for no more than 10 years (January 1, 1991, through December 31, 1999 [9 years], plus the 1-year renewal). Provided Landowner X and Farmer Y experience no landholding changes, they are eligible to submit verification forms (Form 7-21 VERIFY) through the 9-year term of the original lease. However, if the renewal option is exercised, a new standard form will be required because the renewal changes the term of the lease and the original lease is not an annual lease. On the new standard form, January 1, 1991, will continue to be the effective date and the term of the lease will change from 9 to 10 years.

If the initial term of the lease would have been through December 31, 2000, plus the 1-year renewal option, Reclamation would have been required to notify the landholders that the lease did not meet the leasing criteria because the effective length of the lease would be for 11 years. Therefore, the land being leased would have been ineligible to receive Reclamation irrigation water until the lease was either reformed to meet the statutory lease term limit or terminated.

EXAMPLE 3 - *Lease renewal that exceeds 10-year lease term limit*

On March 1, 1996, Landowner C enters into a 5-year lease arrangement with Farmer D. On April 1, 1998, the lease is amended by the parties to extend the termination date from March 1, 2001, until March 1, 2008.

This change effectively created a lease of 12 years, March 1, 1996, to March 1, 2008. After the lease was amended and assuming no perennial crops are grown, Reclamation would be required to notify the landholders that the lease no longer meets the leasing criteria because the action taken on April 1, 1998, created a lease with an effective length in excess of the 10-year statutory lease term limit. Therefore, the land in question would have been ineligible to receive Reclamation irrigation water until the lease was reformed to meet the statutory lease term limit or terminated.

EXAMPLE 4 - Lease renewal that does not exceed 10-year lease term limit

On January 5, 1998, Landowner M enters into a 5-year lease agreement with Lessee N. At the end of the 5-year period (December 2002), both parties agree to extend the lease for an additional 5 years.

Since the total length of the lease does not exceed 10 years, the leasing criteria concerning the term of the lease continue to be met. Landowner M and Lessee N had no landholding changes and, therefore, had been eligible to submit verification forms (Form 7-21 VERIFY) for water years 1999 through 2002 based on the standard RRA forms they each submitted for the 1998 water year at the beginning of the lease. However, submittal of new standard RRA forms for both landholders will be required for the 2003 water year. Even though there has been no change to their lease other than an extension to its expiration date, the longer term for this multi-year lease (which is not an annual lease) is considered to be a landholding change. The effective date of the lease will continue to be January 5, 1998, but the term of the lease will change from 5 years to 10 years (the 5 original years plus the 5-year extension). If the lease should again be extended, it will no longer meet the leasing criteria unless perennial crops are being grown on the land. If that is the case, the lease must be submitted to Reclamation for review and approval.

EXAMPLE 5 - Annual lease that does not meet the statutory requirements

On June 1, 1997, Landowner A enters into a lease with a 12-month term. The lease specifically states that the lease can be renewed annually in writing for 30 years.

While the 12-month term of the original lease and the need for annual, written affirmative action would seem to qualify this lease as an annual lease, the lease term is contrary to statutory requirements as written because "renewed annually for 30 years" creates a 30-year lease term that exceeds the 10-year statutory lease term limit.

If the original lease specified only that it could be "renewed annually in writing," without the reference to a 30-year term, then the lease would be acceptable.

EXAMPLE 6 - Annual lease with renewal provisions that meet the lease term criteria

Landowner R enters into a 1-year lease agreement with Lessee S. The lease agreement includes a provision for annual renewal unless either party terminates the lease or wishes to change the terms of the lease.

This lease meets the lease term criteria. In addition, as long as no provision of the lease is changed and there is no other change to the landholdings of Landowner R and Lessee S after they both submit their initial standard RRA forms, both may annually submit verification forms (Form 7-21 VERIFY) as long as this lease is in place.

Attachment 2: RRA Forms Requirements for Leases

